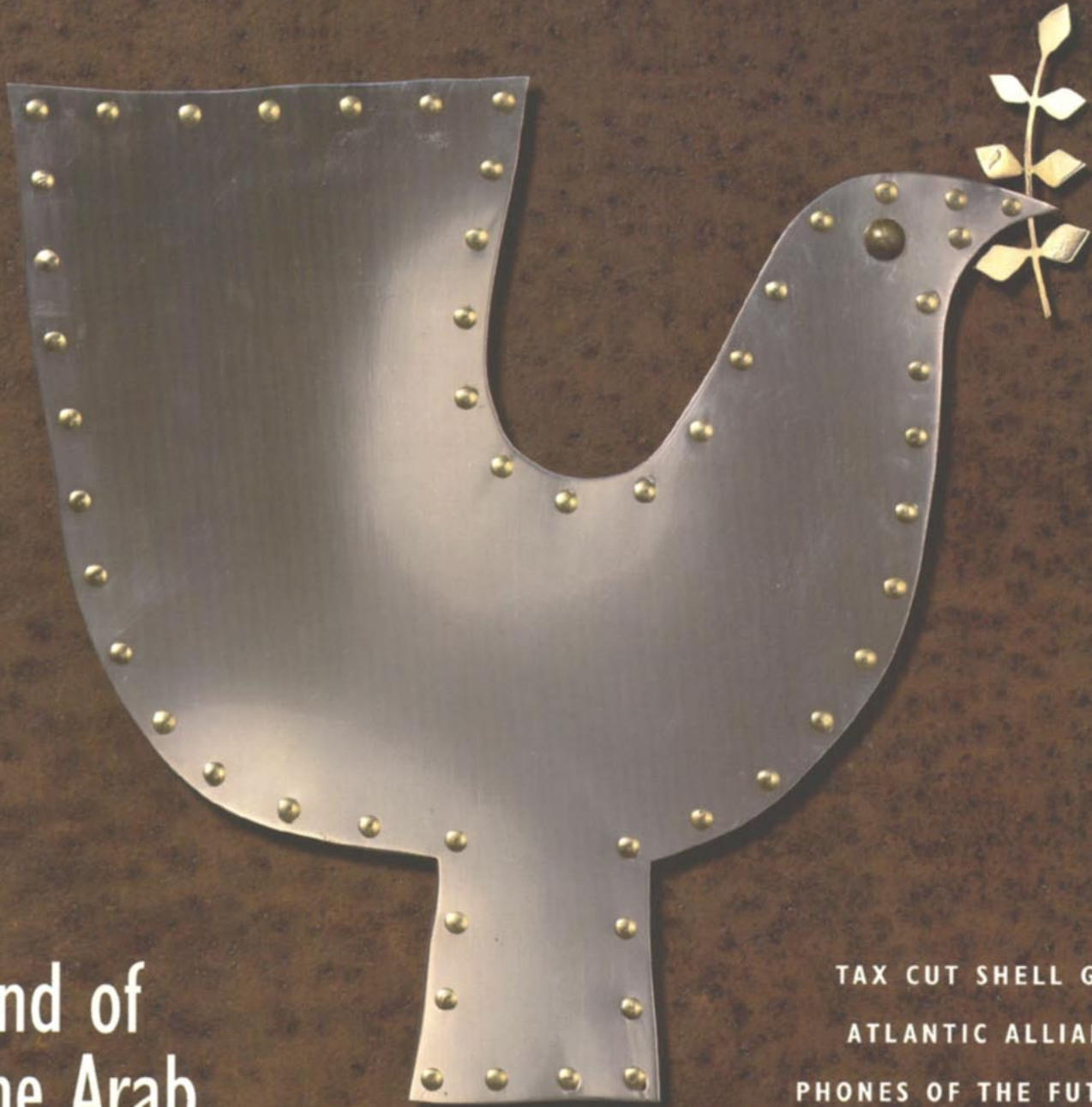


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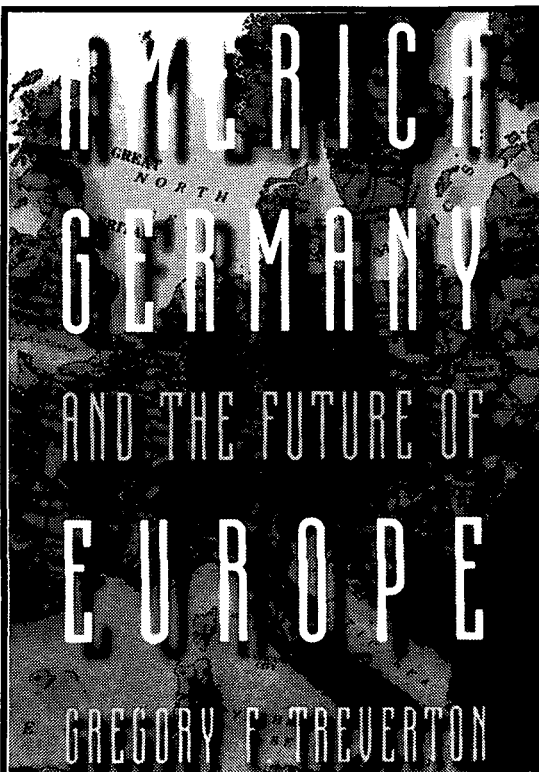
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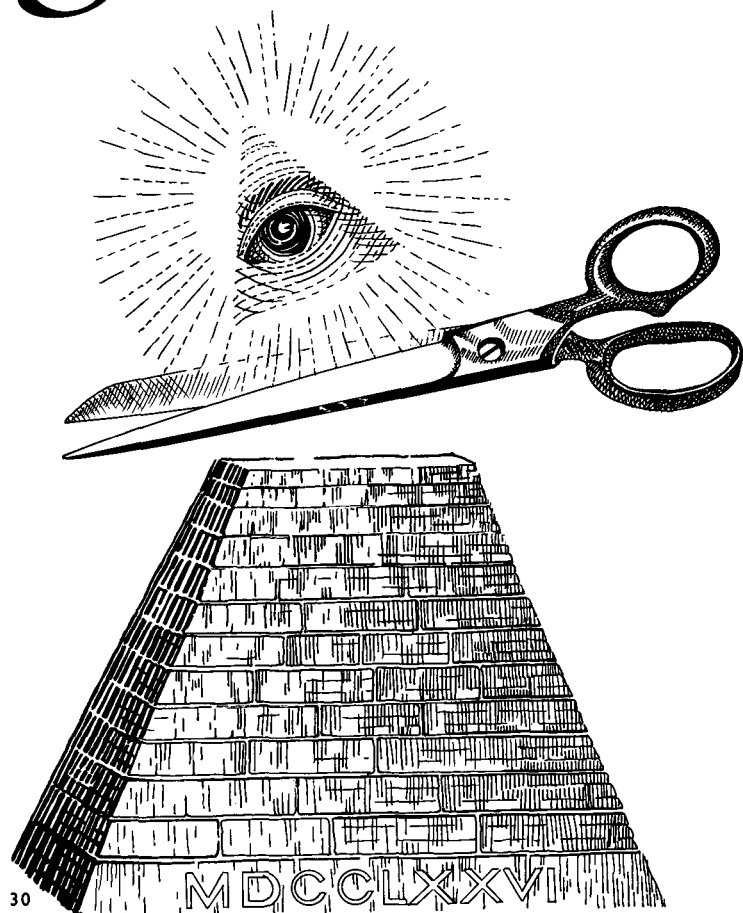
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Rediscovering the Common Good

BY BRUCE K. MACLAURY

This nation is quite appropriately engaged in some deep soul-searching in the aftermath of the Rodney King case and the ensuing riots. While the acquittal of the Los Angeles policemen reemphasizes the immense importance of justice in a democratic society, the riots reemphasize the importance of law and order. Both kindle inflammatory questions about the role of race.

Why, despite a quarter century of progress in breaking down legally sanctioned discrimination, a quarter century that has permanently changed our national consciousness and indelibly altered many individual attitudes toward race—why are prejudice and de facto discrimination still too often encountered in justice, job seeking, housing, financing, schooling, and other facets of everyday life?

Robert Bellah and his coauthors, in *Habits of the Heart*, suggest that the Civil Rights movement has failed to transform the circumstances of minorities in American society because we—all of us—have neglected our “social ecology.” Instead of propagating the values we as a people must share to promote “the common good,” we too often emphasize our separate identities.

Do the roots of urban problems, then, run deeper than race and poverty? The problems themselves are painfully familiar: central cities that have become orphans of society, abandoned by federal and state governments and by middle class flight (white and black) to suburbs; beleaguered mayors left to cope with increasing proportions of residents without jobs, medical insurance, skills, and hope; school systems mired in bureaucracy that fail to reach children emotionally or intellectually; family breakup, depression, and violent crime.

No one disagrees that the roots of such problems must be weeded out and reseeded with something better. But the public, stretched by stagnating incomes and disillusioned with government, is less and less willing to share resources with those beyond their neighborhoods. Moreover, taxpayers increasingly resist underwriting lifestyles that include the drug culture, teenage pregnancies, lawlessness, and welfare dependency. Such problems are increasingly seen as *theirs*, not *ours*.

We seem to have lost the ability to transmit civic values that are so essential to a just and harmonious society. Democracy cannot function if its citizens do not agree on basic social principles and voluntarily adhere to their embodiment in law. That is precisely why it is so crucial that the application of law be seen to be even-handed. It is also why the growing gap between rich and poor, exacerbated by white-collar crime, so undermines the consensus on which society rests.

Rodney King’s poignant question, “Can’t we all just somehow get along?” demands a response not just in a renewed search for common values, but in a reality of new opportunities. Where can we start? An idea that has received too little attention is an expanded national service corps to provide an alternative for unemployed teenagers faced with little more than street gangs and drug dealing. It is ironic that with the end of the Cold War, we are downsizing the armed forces, the very institutions that have the best record in our society of offering employment and training to disadvantaged youth. But what better time to devise a new *civilian* mission for the armed forces, to take advantage of the training skills of officers and non-coms, many of them minorities, as well as some of the training facilities that will otherwise have to be abandoned?

A national service corps could not only provide a structured learning environment for otherwise unemployed young people—offering them an opportunity to broaden horizons, learn valuable skills, and build values of discipline and responsibility—but also help protect the environment and rebuild the infrastructure. Combine such service with education credits for subsequent use to continue or seek advanced training, and one is really talking opportunity.

Moreover, like the armed forces, a national service corps can help bridge the gap between rich and poor and people of all colors. And with the provision of real opportunity, society need not feel concern or guilt for strict law enforcement directed against those who choose crime rather than opportunity.

Like most proposals offering this kind of opportunity, a national service corps would require tax funding. There is no free lunch. But it is hard to think of programs that promise so much in the way of payoffs as one that creates job opportunities and training for unemployed youth, a new mission for an underemployed army, a ticket to further education, an escape from crime-ridden city streets and housing projects, an environmental dividend, and experience in a cross-cultural common cause that could help break down the barriers that separate us. ■



Bruce K. MacLaury is president of the Brookings Institution and has served in that capacity since 1977.

“Old Thinking” about Arms Control

■ It will risk appearing ungrateful to such a dedicated arms controller as Jack Mendelsohn (“Dismantling the Arsenals,” spring issue) to complain that his proposals do not go far enough. It may also appear politically naive and unrealistic. After all, Mendelsohn urges abandonment of our current warfighting strategy and calls for far deeper reductions than the administration seems prepared to contemplate, even as a “vision” for some time in the next century. But Mendelsohn then focuses on measures “to increase the overall confidence of both sides in the survivability of their nuclear forces.” This, I believe, has now become “old thinking.” The debate about nuclear futures should be based on the new fact that any attempt at a disarming first strike by Russia is now just as unimaginable politically as is an attempt by us. Americans and Russians should focus on designing stable force structures and postures with warhead totals in the low tens rather than in the low thousands.

The articulation by the two leading nuclear powers of this kind of “new thinking” would

have an enormous impact on the other most serious threat to world security—the threat of nuclear proliferation. Ukraine, Kazakhstan, India, and other potential or threshold nuclear-weapon states will not be greatly impressed by promises from Washington and Moscow to limit themselves to a thousand or so nuclear weapons. But if the five nuclear powers credibly commit themselves to come down to levels somewhere near zero, the nonnuclear nations may be more cooperative about our efforts to discourage them from getting even one.

James Leonard, Washington Council on Non-Proliferation

The Politics of Arms Control

■ Ironically, the very absence of the Cold War that makes arms control more attainable (Mendelsohn, “Dismantling the Arsenals,” spring issue) also makes it politically less compelling. Even with the new “declaratory arms control” that avoids the tediously detailed negotiations of the past, there will be decreasing political interest among policymakers in

devoting major time and attention to arms control. We may be entering an era in which arms control occurs largely as a result of domestic budget decisions rather than well thought out arms control policies.

Conversely, halting proliferation is now more compelling but also more difficult. The Iraq case has likely undermined the value of the Nuclear Non-Proliferation Treaty as it revealed that treaty’s worst kept secret: the nation that wishes to proliferate likely will do so. Indeed, the future of any meaningful proliferation policy may depend more on international coercive or punitive measures than moral suasion, if the international community feels up to it.

This is not to suggest that we do not have new opportunities to make the world a bit safer. But we must remember that arms control is not an abstract concept or a preordained given. It is a policy whose pursuit, failure, or success, is grounded in and limited by the politics of the period.

Mark M. Lowenthal, Congressional Research Service

Setting the Record Straight

■ Marc Mauer’s letter (spring issue) on my article, with Anne M. Piehl, “Does Prison Pay?” (fall issue) contained several incorrect, misleading, and unfair statements. First, the heading the *Review* gave his letter was “Prison Is Not the Only Answer.” Our article did not begin to suggest that it was.

Contrary to his letter, we did not suggest that community-based supervision programs have zero effect on crime control, or imply that the country should “rush to lock up even more people.” I have written extensively on the efficacy of some such programs, including one article published in the *Review* (“Punishing Smarter,” summer 1989).

Calculating the national incarceration rate relative to the country’s crime pool paints a less alarmist picture than his advocacy group, The Sentencing Project, favors. For example in 1960 there were 62 commitments to state prisons for every 1,000 serious crimes. By 1970 the number had dropped to 23. In the 1980s it climbed steadily back to 62, which is what it was in 1989. In many states the rate of increase in the use of community-based alternatives to incarceration far exceeded the rate of increase in the use of prisons and jails. Today nearly three out of every four convicted criminals are not behind bars. Even with mandatory sentences, most convicted criminals spend less than 50 percent of their time behind bars, and the likelihood of being sentenced to prison if convicted is less than 50 percent for all crimes except homicide.

As our study indicated, for some types of offenders incarceration is almost certainly not the most sensible and cost-effective sanction. But, as we stressed, more research is badly needed. What the numbers will show remains to be seen.

I appreciate that Mauer’s advocacy group gets lots of sensational headlines and is widely cited in public debates. But there is a difference between assertive policy advocacy and credible policy analysis. We all should learn to respect that difference, not trivialize it.

John J. DiIulio, Jr., Princeton University

Horsetrading on Trade Issues

■ Richard Boluck and Robert Litan (“Down in the Dumps,” spring issue) must have missed the newspaper accounts of the initiatives advanced by the Bush administration in the Uruguay Round over the past three years to ensure that antidumping and



Reviving the American Dream

BY ALICE M. RIVLIN

Americans, long noted for their "can-do" spirit, for self-assurance often bordering on cockiness, have become mired in pessimism. It has become fashionable to predict decline in America's economic strength and stagnation in its standard of living. Foreboding about the economy has fed popular anger at the political system, especially at the federal level.

To visitors from less favored parts of the world, this defeatism must seem mystifying. There are no objective reasons for discouragement about America's economic future, unless the low expectations themselves become self-fulfilling. The United States has enormous natural and human resources. Americans still have the world's highest productivity and standard of living. The challenges facing the American economic system today are not especially daunting compared with challenges that it has met in the past or that face many other economies today.

Even as the American dream has faltered, a consensus has grown up, among liberals and conservatives alike, on how to revive that dream. We must ensure sustainable and widely shared increases in the standard of living. Private investment, embodying new technologies and processes, must increase. Domestic saving must be stepped up to finance this investment. To generate greater saving, the federal budget should move from deficit to surplus. But it will also be necessary to increase public investment to improve education and work skills, modernize infrastructure, and keep the country on the frontiers of science and technological change.

The federal government cannot simultaneously make large new public investments and eliminate the deficit without a huge tax increase. And the public will not support such an

increase given its current attitude toward Washington. Moreover, the federal government is not well suited to take responsibility for improving education, training, and infrastructure or fostering economic development. These are functions of government that require experimentation, adaptation to local conditions, accountability of on-the-scene officials, and community participation and support.

What is needed is a new division of the domestic responsibilities of government. The federal government should continue to do what it has proved it can do well: strengthen the nation's social insurance system. It should take on the task of controlling the growth of health costs and ensuring that everyone has health insurance. It should devolve its programs in education, infrastructure, and economic development—what I call the "productivity agenda"—to the states, who are better suited to manage them.

Devolution will help move the federal budget toward surplus. Some federal tax increases will be needed, earmarked for the new health insurance plan so that taxpayers know what they are paying for. To support the productivity agenda, states should strengthen their revenue systems by sharing the proceeds of one or more common taxes, as is done, for example, in Germany.

The restructuring that is needed in government is akin to that now in progress in American business management. Frightened by gloomy forecasts and spurred by foreign competitiveness, many American companies are rebuilding themselves from the bottom up. They are improving the quality of products and services, increasing responsiveness to customers and clients, and empowering workers to contribute



to company success. They are refining their missions, developing expertise in a set of closely related lines of business. The goal is to do what they do well and resist excursions into unrelated business where they do not have proven competence.

The business revolution is spilling over into government. Many of the themes are the same: the entrepreneurial spirit, responsiveness to the public, decentralization, empowerment of front-line workers. Reformers in government also emphasize the need to clarify missions and make sure everyone knows who is responsible for what. Sorting out the functions of government—both between the federal government and the states and within the states—would help move government further in that direction. It would also help restore people's confidence that they can actually affect what happens in government.

America's federal form of

government makes such far-reaching changes more than just a dream. For 200 years our government has been evolving in accord with changing perceptions of the needs of the country. From the 1930s to the 1980s, power and responsibility flowed from the states to Washington—for good reasons and with many good results. Now there are good reasons to begin rechanneling that power and redividing that responsibility. ■

Alice M. Rivlin is a senior fellow in the Brookings Economic Studies program and professor of public policy at George Mason University. This article is adapted from Reviving the American Dream: The Economy, the States, and the Federal Government (Brookings, 1992).



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SANDSTORM WITH A SILVER LINING?

PROSPECTS FOR ARMS CONTROL IN THE ARAB WORLD

*Yahya
Sadowski*

There is a growing debate in the Arab world about military spending. The debate has been triggered not by a reduction of hostilities in the Middle East or by a sudden outbreak of pacifism, but by cold economic logic. Over the past decade, declining oil prices, overpopulation, economic mismanagement, and foreign policy adventurism have combined to wreak havoc on the economies of the Arab states. The Gulf War aggravated this trend, even for those states that suffered minimal physical damage, by destroying the system of aid donations and labor migration that used to transfer capital from the oil-rich states of the Gulf to their poorer neighbors. Economically exhausted, many Arabs are searching for cheaper ways of meeting their national security needs. The result is the most promising setting for arms control talks the region has seen in 40 years.

Wracked by War

Few Westerners appreciate the magnitude of the economic changes that the Gulf War imposed on the Middle East. Estimates of the cost of the war to the Arabs range from \$200 billion to \$500 billion—and the higher estimates are probably more accurate. Even the smaller figure is twice the annual value of oil exports from all Arab states.

It is difficult to assign a precise figure to the damages caused by the war, partly because the costs are still piling up. During the war, allied air forces demolished Iraq's electrical power plants and transmission grid. Repairing these facilities will cost Iraq \$12 billion, but the interim cost to the economy of operating with only 20–25 percent of prewar levels of electrical power is much, much higher. The loss of electrical power has idled sewage pumps and water treatment plants, thereby fostering the spread of disease. Two-thirds of all households have access only to contaminated water, causing epidemics of gastroenteritis, typhoid, and cholera. Without power, Iraq has not been able to operate its irrigation pumps, reducing agricultural production to half of prewar levels. Massive price rises—1500 percent to 2000 percent—for staple goods have wiped out the personal savings of most Iraqi families. The repercussions of these damages, exacerbated by the continuing United Nations embargo, will cripple Iraq for years to come.

Such cascading effects of the war are not confined to its physical damage. In fact, the physical damage actually cost the states involved less than the economic disruption it created. For example, the war displaced at least 5 million people. Some, like Egyptian guestworkers and Kurds in Iraq, fled for fear of combat. Others, like 200,000 Palestinians in Kuwait and 800,000 Yemenis in Saudi Arabia, were expelled because their home gov-

Yahya Sadowski is a senior fellow in the Brookings Foreign Policy Studies program. This article is adapted from his forthcoming Brookings occasional paper, Scuds or Butter: The Political Economy of Arms Control in the Arab World.

ernments aligned with Iraq. The result has been a near-total collapse of the export of labor from poorer Arab states to their richer neighbors, which had been the major source of hard currency for the former.

The full effects of this disruption are slowly becoming more evident and more painful. Consider the case of Jordan. Some 300,000 holders of Jordanian passports fled the Gulf states and returned to Amman last August, raising the unemployment rate to 25–30 percent. The return of these expatriates forced Jordan to increase its imports and cost it \$1 billion in hard currency remittances. Compounding these problems was the closure of Saudi markets, the drying up of all foreign aid (including oil supplies) from Arab states, and the embargo of Iraq, Jordan's largest trading partner. As a result, Jordan's gross national product fell 17 percent last year. In rural areas of the country nearly a third of the people live below the poverty line.

And things are likely to get worse. The funds brought back by the returning Jordanians are being steadily depleted. Another 100,000 Jordanians, mostly Palestinians, are expected to be forced out of Kuwait by the end of the year. Last year Europe and Japan contributed \$900 million to help settle the returnees, but that aid has now been terminated. The United Nations estimates that Jordan will need \$3–4 billion over the next five years to provide housing, schools, electrical grids, and social services for the returnees.

Costly Even for the Winners

Even in countries that experienced neither serious physical damage nor disruption of labor exports, the effects of the war have been dramatic. During the year following August 1990, support of the crusade against Iraq cost Saudi Arabia \$60–80 billion—\$23 billion in contributions to the allies, \$18 billion in arms purchases, \$12 billion to insulate the economy from the panic that gripped the Gulf immediately after the invasion, and \$5 billion to expand oil production facilities. And all that came on top of the \$10 billion deficit the Saudis had already written into their budget.

The \$14 billion windfall the Saudis netted from expanded oil production and rising oil prices during the year after Iraq invaded Kuwait does not begin to cover these costs. They have been forced to tap into their cash reserves, which may have been \$35 billion when the crisis began. They have also, for the first time, had to borrow. Last year the Saudi government secured \$9 billion in loans from commercial banks and hoped to borrow heavily from the \$20 billion of deposits in domestic banks.

These developments in Saudi Arabia are part of a much wider trend. The Kuwaiti government, too, has authorized foreign loans totaling \$35 billion to finance the rebuilding of its economy. Iraq had already piled up \$90 billion in foreign debts before the Gulf War began. Relative to GNP, the foreign debts of Egypt, Jordan, Morocco, South Yemen, and the Sudan are larger than those of Brazil, Mexico, the Philippines, or Poland. In 1980 the most important resource the Arab world possessed in the race for economic development was capital assets. Now these are gone. A capital-rich region has become a capital-poor one. All but a hand-

ful of states in the region have become serious debtors.

Much of this debt was acquired to finance military expenditures. Between 1973 and 1982 the Arabs exported \$1 trillion in oil. During the same years they spent \$350 billion, one-third of the total, on their militaries. After 1981, oil prices began to fall, dropping the value of Arab oil exports from \$180 billion in 1980 to \$90 billion (in current dollars) by 1987. Yet arms spending continued to climb. Between 1977 and 1988 the Arabs imported \$177 billion worth of weapons. During the 1980s one-third (by value) of all weapons traded internationally wound up in the Middle East. As table 1 shows, the Middle East is the most heavily militarized region in the world.

Arms spending, and the borrowing necessary to finance it, fell heavily on the shoulders of the man in the street. By the late 1980s many Arab states were forced to curtail social spending to meet their debt payments. Some adopted economic austerity programs to secure International Monetary Fund support for debt rescheduling. The declining standard of living triggered virtual revolutions in the Sudan in 1985, in Algeria in 1988, and in Jordan in 1989.

Chastised by these insurrections, Arab governments began to rethink the way they allocated funds. Arab officers found themselves under increasing pressure to curtail their arms spending to free up funds for debt service and social investments.

The Gulf War made it more difficult for Arab officers to defend their budgets. First, the cost of repairing the physical damage and economic dislocations caused by the war added to the pressure on state finances. Second, allied forces in the Gulf had deployed a new generation of high-technology conventional weapons, including advanced targeting and navigation systems, cruise missiles and stealth fighters, and sundry smart munitions. The new weapons had completely overwhelmed the Iraqi military, the largest and most advanced in the Arab world. The Gulf War demonstrated that existing Arab arsenals were obsolescent and confronted Arab officers with the prospect of having to completely refurbish their weapons stockpiles at enormous cost.

The Best and the Brightest?

Most important, the allied victory greatly undermined the prestige of Arab militaries, including those of the states that had joined the fight against Iraq. The Kuwaiti army was enthusiastic but deliberately under-supplied by a government that did not trust its troops, many of whom were not Kuwaiti citizens. The Saudi army, which Western analysts described as “a garrison army” highly dependent on “Filipino bottle washers and Pakistani mechanics,” was carefully confined to flag-planting duties. The Syrian and Egyptian troops in the Gulf showed greater professionalism than other Arab forces, but, unit for unit, their combat potency appeared minuscule compared with the Western forces in the alliance. Collectively, Arab officers suffered a massive loss of prestige. The disappointing battlefield performance of Arab armies had not only economic but political ramifications.

For years, the military has enjoyed pride of place in the budgets and political calculations of Arab states.

Army equipment was thought to form the cutting edge of technology transfer; military factories were supposed to pioneer industrial development; educated officers were considered among the most modernized groups in society. Not only did they institutionally receive the lion's share of the state budget, but the officer corps itself was lavished with privileges: subsidized housing, special stores offering imported goods below cost, not to mention access to cars, land, and political power.

The loss of prestige that followed the Gulf War imperiled all this. Growing numbers of Arabs began to question whether the performance of their armies justified the high price of sustaining the arms race. Last December the *Front Islamique du Salut* swept national elections in Algeria on a platform that included a promise to cut the military budget and divert the savings into social expenditures. Only a military coup prevented the *Front* from delivering on its pledge.

Budgetary Hardball: The Syrian Case

The example of Algeria suggests that Arab officers remain determined to resist direct challenges to their privileges. But elections are not the only—or the most effective—arena where civilians can seek to curb military spending. Recent events in Syria embody a more widespread pattern.

For its participation in the coalition against Iraq, Syria received about \$2 billion in aid from the Gulf states. A spate of recent reports have suggested that the Syrians might use the money to go on a shopping spree in the global arms market: buying tanks from Czechoslovakia, missiles from North Korea, and new jet fighters from the former Soviet Union. As 1992 unfolds, however, Syrian arms purchases appear surprisingly moderate.

In part, the anticipated shopping spree has been obstructed by international political pressures. Lobbying by the United States blocked a planned sale of missiles from China and curtailed purchases from Czechoslovakia and North Korea. The greatest obstacle to these sales, however, was economic. The former republics of the Soviet Union insisted on cash in advance before contemplating any new arms deals with Damascus. Yet, despite the Syrian government's "war dividend," the Syrian military did not have the needed funds.

The reason was that civilians in the Syrian cabinet and technocrats, ranging from portfolioed ministers down to middle-echelon bureaucrats, had earmarked much of the war dividend for nonmilitary purposes. During the economic crisis of the late 1980s, the influence of these technocrats had waxed just as that of officers had waned. After the Gulf crisis, these civilians competed successfully with the officer corps for claims on government funds. They argued that investing the Gulf War windfall in the economy would ultimately generate more revenue, even for the military, than spending it immediately on arms imports.

For example, one minister appealed to the president to earmark \$200 million for the construction of a steel plant in Hama. He noted that he could use these funds to lure Gulf governments into lending the remaining \$300 million he needed to fund the plant. The government gave him the money. Other tech-

nocrats, encouraged by this example, learned that if they could get the government to fund part of a project, they might be able to find private or foreign capital for the rest. They realized that if they could get a project started, they would later be in a better position to argue that the government should fund its completion. In the nine months following December 1991, Syrian ministries issued \$2 billion in civilian tenders. No one believed that all would be funded, but it was clear that the technocrats were bidding for—and hoped to win a large share of—the cash contributions the government had received from the Gulf.

Civilian technocrats became bolder partly because they understood that public opinion was on their side. During the late 1980s no funds had been available for investment in Syria's economic infrastructure; enterprises and public buildings had fallen into shabbiness and disrepair. Despite inflation that ran as high as 60 percent annually, there had been no funds to raise the wages of public sector employees, who formed half of the nonagricultural work force. Most Syrians agreed that the economy deserved priority over the military in the state budget. Many began to argue publicly that the country's real battle was not with Iraq or even Israel, rather "Our war is with poverty."

Guns and Butter

Three years ago Syria had a truly eye-opening experience with the relative value of military and commercial spending. The Soviet Union, fearing a Syrian default on \$10 billion of outstanding military debts, agreed to ac-

Table 1. The Level of Militarization, 1988

REGION OR COUNTRY	MILITARY SPENDING AS A PERCENT OF CENTRAL GOVERNMENT SPENDING	MILITARY SPENDING AS A PERCENT OF GNP	MILITARY SPENDING PER CAPITA	ARMED FORCES PER 1,000 POPULATION
LATIN AMERICA	6.9 %	1.3 %	\$ 27.87	3.7
EAST ASIA	11.0	2.0	44.76	4.7
AFRICA	13.6	4.2	25.28	2.9
SOUTH ASIA	16.8	3.8	11.81	1.9
EUROPE	17.2	6.1	633.60	11.1
UNITED STATES	27.5	6.3	1,250.81	9.1
MIDDLE EAST	30.1	8.8	344.49	18.3

Source: U.S. Arms Control and Disarmament Agency.

cept repayment in Syrian liras—provided that the Soviets were permitted to spend these sums in Syria and to export the goods they purchased. The Syrians agreed, and the Soviets began spending millions of lira worth of Syrian “funny money” on textiles, shoes, fruits, vegetables, and other commodities not traditionally exported by Syrians because of poor quality control, sparse marketing facilities, and government regulations. Soviet spending made certain Syrians millionaires, sparked a wave of investment in export industries, and dramatically improved the Syrian balance of trade.

That experience made many Syrians appreciate the full price that their country had paid for its military buildup. Selling Hafiz al-Asad on the benefits of slowing the arms race will still be difficult, but there are many within the civilian bureaucracy and among the country’s economic elites who would (quietly) like to persuade him.

Hard Economic Questions

Presidents everywhere prefer to focus on international relations and security questions at the expense of economic issues. That is particularly true in the Arab states, where the president has often been installed or at least maintained in power by the army. Yet the economic burdens of the Arab world are so dramatic that they have forced a reorientation of executive thought. For several years now Mubarak, Ali Abdullah, and Ben ‘Ali have been compelled to devote the bulk of their working hours to economic questions. Two years ago Asad was compelled to abandon his program

of “strategic parity” with Israel, largely because of economic pressures.

The squeeze on military budgets has set Arab leaders searching for cheaper means of providing for national security. A growing number believe that arms control offers a solution. In the West—which can afford to build and maintain huge arsenals—arms control is generally viewed as an idealistic program, motivated by a desire to live in peace. In economically troubled developing countries, the perception is quite different: arms control is a way for the state to deny its adversaries weapons that it cannot afford. Arms control agreements allow a state to reduce its own arsenal and cut its military budget while simultaneous reductions among its opponents ensure no erosion of its overall security. The cold economic calculations that prompt arms control proposals in the third world may actually prove more reliable and durable than the altruistic motives cherished by the West.

Most Arab states endorsed the wide-ranging proposal for Middle East arms control unveiled by President Bush in May 1991. The proposal, which has since died a slow death, would have regulated the production, trade, and deployment of nuclear devices, surface-to-surface missiles, and chemical and biological weapons. Bush also called for negotiations among the major countries that supplied arms to the region aimed at stemming their flow. Egypt, in particular, trumpeted its support of the Bush initiative, which it saw as an elaboration of Mubarak’s 1990 proposal to eliminate weapons of mass destruction from the region. The Mubarak plan, in turn, built on a series of Egyptian efforts since 1974 to promote creation of a nuclear-free zone in the Middle East.

Economic motives underpinned Egypt’s strong interest in nuclear nonproliferation. Already in the 1960s Cairo had decided that any program to develop nuclear weapons would be too expensive to sustain. The experience of the one Arab state that implemented a serious nuclear development program, Iraq, testifies to the wisdom of the Egyptian decision. Baghdad spent 20 years and at least \$20 billion trying to build a nuclear weapon. Even so, in 1991 Iraq still did not have a workable design for a bomb and was still three to five years away from having enough enriched uranium to construct a viable nuclear device. During the Gulf War many of the Iraqi nuclear program’s key components were destroyed, and after the war the surviving elements fell under UN control. Viewed as a “technology transfer” project, the Iraqi nuclear program may be the most expensive single failure in the history of the third world.

Jordan’s Arms-for-Debt Swap

Proposals to control nuclear weapons are not the only ones with currency in the Arab world. Since the end of the Gulf War, Jordan has launched a program of unilateral arms reductions to reduce military spending. Amman canceled its billion-dollar contract to purchase Mirage jet fighters from France and suspended a similar contract for Tornado fighter-bombers. King Hussein abolished universal military conscription, and the number of troops in the Jordanian armed forces de-

Table 2. How the Jordanian Debt-for-Arms Swap Might Have Worked in 1987

	MILITARY SPENDING (MILLIONS OF DOLLARS)	MILITARY SPENDING AS A PERCENT OF GNP	TOTAL EXTERNAL DEBT (MILLIONS OF DOLLARS)	EXTERNAL DEBT AS A PERCENT OF EXPORTS OF GOODS AND SERVICES	PERCENTAGE OF TOTAL DEBT RETIRED
EGYPT	\$ 8,038	11.5 %	\$ 49,628	455.1 %	6.5 %
IRAQ	n.a.	n.a.	n.a.	n.a.	n.a.
ISRAEL	6,101	14.6	16,767	50.5	14.6
JORDAN	590	13.9	5,279	163.9	4.5
OMAN	1,518	20.8	2,850	n.a.	21.3
SYRIA	1,472	11.5	4,695	244.0	12.5
YEMEN	310	6.5	2,631	263.3	4.7

n.a. Not available

Sources: U.S. Arms Control and Disarmament Agency, World Bank.

clined from 130,000 at the beginning of 1991 to 107,000 by the end of the year and is expected to drop to 95,000 by this fall. The program is obviously risky for Jordan, leaving it vulnerable to military and political pressure from Israel, Syria, and Iraq, all of whom have a history of intervening in Jordanian affairs. The Jordanians, eager to encourage their neighbors to make similar arms cuts, have floated a remarkable proposal.

The Jordanians observed that the arms race in the Middle East has been fueled by a vicious circle: expensive debt service stifled Arab economies and bred poverty, poverty fueled violence, violence stimulated arms purchases, arms purchases required foreign borrowing, foreign borrowing aggravated the debt crisis, and so on. To break the cycle, the Jordanians advocate an "arms-for-debt" swap. They propose that any state in the region that is willing to curb its military spending should be rewarded by a proportionate reduction of its outstanding public debt. Table 2 illustrates how this program would work if the states of the region each agreed to reduce their military expenditures by 20 percent and if their creditors agreed to forgive two dollars of debt for each dollar reduction in their military budgets.

This kind of program might prove appealing to some of the biggest arms consumers in the region. Egypt, Israel, Jordan, and Syria would be able to retire their foreign debts in less than 20 years. It might also prove appealing to some of the region's creditors. Unlike Latin American states, whose creditors are mostly private banks, Middle Eastern states borrowed from foreign governments. Governments are more receptive than banks to the idea of debt forgiveness, particularly since economic conditions in the Middle East are so dismal that there is little prospect of collecting these loans anyway. An arms-for-debt swap would give both Middle Eastern states and their foreign creditors an opportunity to pursue policies that are an economic necessity while portraying them as an act of political virtue.

A New Wave of Arms Buying?

There is some danger, however, that these arms control proposals will soon be eclipsed by a new round of the regional arms race. As much as they would like to save money, Arab states cannot afford to lag too far behind their neighbors in arms acquisitions. And certain states in the region have already found foreign suppliers who are willing to infuse large quantities of the newest high-technology weapons into the region. This threat of proliferation, sadly, arises not from the actions of Syria and North Korea or of Iran and China, but of Saudi Arabia and the United States.

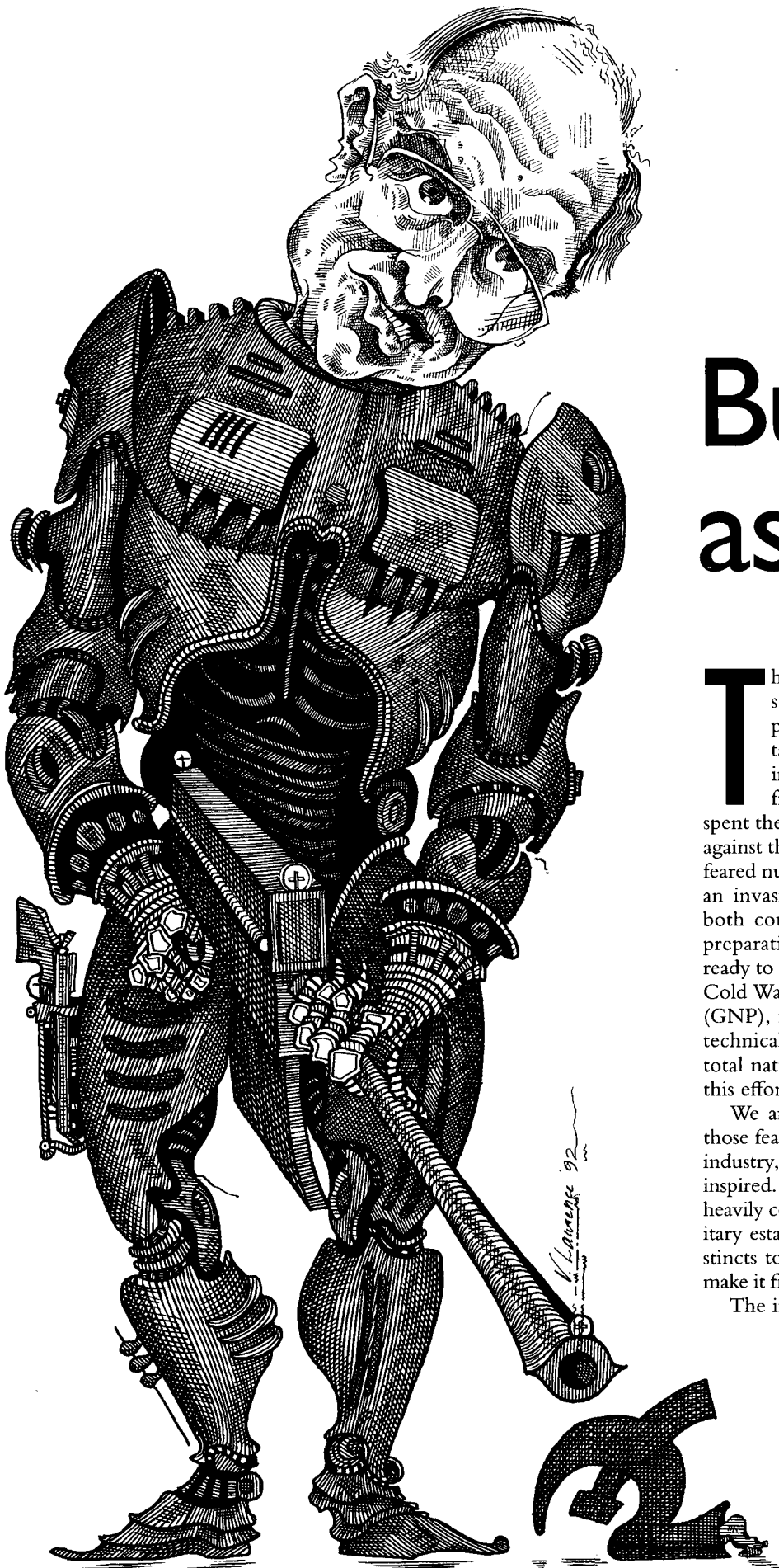
Rattled by the threat of an Iraqi invasion, Riyadh has decided to increase the size of its armed forces from their current level of 76,000 to more than 200,000 troops. They also want to arm these forces with the very best weapons money can buy, the wonder weapons whose blistering effectiveness the Americans demonstrated during Operation Desert Storm: the M1 Abrams main battle tank, the M2 Bradley infantry fighting vehicle, the UH-60 Black Hawk transport helicopter, the AH-64 Apache attack helicopter,

and the Patriot air defense missile. Immediately after the Gulf War Riyadh presented Washington with \$23.5 billion worth of weapons orders for its ground forces alone. The Saudis were also planning to double the size of their air force and hoped to spend \$4 billion for the purchase of 72 F-15 fighter planes.

Because of the costs of the Gulf War, even Saudi Arabia has had a little trouble finding the funds for this new escalation of arms purchases. Riyadh has had to cancel some older arms contracts to free up funds for new ones and has sometimes stalled payments on arms received to avoid a cash crunch. The Saudis are confident, however, that by stretching their budgets and borrowing abroad they can finance their military expansion—particularly since Washington seems so eager to sell. The result has been an unprecedented flood of arms sales: the United States sold the Saudis \$14.8 billion worth of weapons between August 1990 and December 1991 alone. And the example (or the threat) of the arms buildup in Saudi Arabia is encouraging other states in the region to follow suit. In January 1991 the White House had already notified Congress that it was considering \$23 billion worth of weapons sales to the Middle East for that year alone.

Despite President Bush's assertion that "it would be tragic" if the Gulf War were followed by a renewal of the arms race in the region, the United States has emerged as the largest weapons proliferator in the Middle East market. When queried about this development, American officials replied with the formula that "there is absolutely no contradiction between arms control and arms sales." But this is highly disingenuous. American arms sales *do* undermine the prospects of arms control in the region. They undercut America's credibility in negotiations with other countries to try to curb the supply of weapons to the region. They fuel a vicious circle of arms acquisitions that quickly spreads beyond the Gulf to encompass the entire region. When the Kingdom of Saudi Arabia enhances its armaments, it (perhaps) inadvertently triggers anxiety in Tel Aviv. When Israel responds by enhancing its own arsenal, it forces a corresponding escalation in Syria (and Jordan or Egypt). The growth of the Syrian military may provoke a response in Turkey or Iraq. The growing power of Istanbul or Baghdad may ignite a buildup in Iran, threatening Saudi Arabia, and setting the whole vicious circle in motion again. All too often, the expansion of the military or introduction of new weapons into any state in the region provokes a similar escalation in all the rest.

Only if these sales can be curbed is there any real hope of capitalizing on the economic trends that have recently made arms control alluring in the region. "Incentive programs," such as the Jordanian arms-for-debt proposal, offer an unprecedented opportunity to propagate arms control in the region. They could build on pre-existing trends in the Middle East, reinforcing the weight of economic forces, finding a receptive audience among financial technocrats and civilians who have been trying to win funds for investment in development. But without some restraint by the arms purveyors at the Pentagon, they do not stand a chance. ■



Business as Usual?

The dissolution of the Soviet Union has presented the United States with a demanding political problem: how to change a well-established consensus that has long justified the investment of large sums of money. Each year from 1950 through 1990, the United States spent the equivalent of \$278 billion in today's dollars against threats emanating from the Soviet Union. We feared nuclear bombardment of the United States and an invasion of Western Europe. We believed that both could occur suddenly, leaving little time for preparation. We therefore constructed large forces ready to operate on short notice. On average over the Cold War years, 7.8 percent of our economic product (GNP), more than half of the federal government's technical investment, and about one quarter of our total national technical investment was absorbed in this effort.

We are now relieved of the original reasons for those fears but not of the military forces, the weapons industry, or the pattern of technical investment they inspired. We have skills, jobs, traditions, and emotions heavily committed. Having built the most capable military establishment in the world, we have strong instincts to preserve it. But we do not know how to make it fit a dramatically altered international situation.

The initial reaction, as reflected in the official de-

The Redesign of National Security

fense budget and associated planning documents, is the predictable marginal adjustment. A schedule has been set to cut U.S. forces by about 25 percent from their 1990 base and their annual financing by about 28 percent. That will produce a defense budget in 1997 that is only 13 percent below the Cold War average and only 8 percent below it if spending associated with the wars in Korea and Vietnam is excluded. The justification no longer mentions the Soviet Union but continues to speak generally of unspecified threats of the traditional variety that might arise on short notice. We propose to conduct security as we have done it before, avoiding the thought that circumstances might require something different.

Understandable as it is in human and political terms, this clinging to tradition is not likely to be the end of the story. Common sense, competing economic priorities, and international political sensitivities will almost certainly drive U.S. forces to lower levels than currently planned and will probably induce a less confrontational attitude. If we muster the wit to make a virtue of these eventual necessities and if we organize the process systematically, we can be better defended against traditional threats at lower cost. We can also be better configured to deal with new threats of entirely different character. As compared with the current defense budget projection, we could save some \$210 bil-

lion (in constant 1992 dollars) over five years, \$640 billion over ten years, and \$85 billion a year thereafter. These sums are appreciable and are bound to command attention.

Even these savings would permit overall defense spending of more than \$1 trillion (in 1992 dollars) for the five years 1993–97, nearly \$2 trillion for the decade, and \$155 billion annually thereafter. Under this budget, the reduced forces could replace and upgrade their equipment at a stable rate and could maintain their operational proficiency. At substantially lower cost, the United States would have better security than it has traditionally enjoyed.

Meeting the Diminished Threat

The first and most obvious step is to adjust to the disappearance of plausible and competitive opponents. The dissolution of the Soviet Union, the ongoing reconfiguration of its military establishment, and the damage done in the Persian Gulf War to Iraq's military assets have essentially removed an immediate conventional threat. There is no possibility that a major conventional aggression—the seizing of territory by force—can be undertaken by an antagonistic military establishment without preparation that would literally take years. All the advanced military establishments are now effectively allied with the United States, and we

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could readily defeat any attempted aggression with a small portion of the assets now at our disposal.

As the principal military successor to the Soviet Union, Russia has acquired the primary responsibility for maintaining the arsenal of nuclear weapons that could wreak havoc with long-range bombardment. As is now widely recognized, however, aggressive use of these weapons can be deterred with a fraction of existing U.S. strategic weapons deployments. With many capable friends and no enemies of commensurate strength, U.S. forces can achieve the traditional objectives of deterrence and containment with forces significantly lower than the administration has proposed. Tailoring U.S. forces more reasonably to the threats they actually face would result in about two-thirds of the budget savings noted above.

Table 1. Defense Plans Compared, Budget Authority, 1993–2002

(BILLIONS OF 1992 DOLLARS)

FISCAL YEAR	ADMIN- ISTRATION PLAN	COOPERATIVE SECURITY PLAN	SAVING
1993	270.2	256.7	13.5
1994	260.1	232.2	27.9
1995	254.2	210.1	44.1
1996	246.4	190.0	56.4
1997	241.8	171.9	69.9
1998	241.8	155.5	86.3
1999	241.8	155.5	86.3
2000	241.8	155.5	86.3
2001	241.8	155.5	86.3
2002	241.8	155.5	86.3
TOTAL (050)	2,481.7	1,838.4	643.3

Source: *Department of Defense Annual Report* (February 1992) and the author's calculations. The National Defense account (050) includes the Department of Defense (051), Department of Energy (053), and other defense-related activities (054).

The Changing Character of the Security Threat

But the international security threats have not only diminished, they have also changed in character. The Soviet establishment, which has been the primary source of traditional threat and whose successors still possess the largest weapons inventories, is caught up in a process of radical political and economic transformation. A financial crisis grips all the states emerging from the collapse of the union government. They will not be able to sustain, either individually or collectively, the military establishment they have inherited at anything like its recent size. The residual military forces will certainly undergo a precipitous decline for which there has been no systematic preparation. The planning mechanisms necessary to control such an extremely demanding process are in disarray.

The implications are clear and stark. The armed forces of the new Commonwealth are neither able nor inclined to use any significant conventional weapons beyond their own territory. Nor could they use their nuclear weapons as instruments of attack or intimidation without exposing themselves to countervailing threats that would be disproportionately dangerous to them. Their own fears of vulnerability have become far more compelling than any residual inclination to pose threats abroad. The current imperative within the Commonwealth is to consolidate control of weapons deployments and force operations and to avoid chaotic disintegration of the entire military structure. The loss of responsible political control within the Commonwealth over large conventional and nuclear weapons inventories and over the design and production teams that created them is the most urgent problem of international security. The disintegration of the Commonwealth security establishment could irreversibly hasten the global spread of weapons, dramatically worsening international security for decades to come.

The developing political institutions within the states of the new Commonwealth cannot reasonably be expected to manage their military forces in isolation, particularly if they must operate in terms of traditional policies of confrontation, however mitigated. They clearly will need substantial reassurance and direct assistance from the international community if they are to reduce, relocate, and stabilize their still very

large military establishment. An equitable and legitimate framework for that assistance must be established if it is to have any hope of succeeding. Traditional methods of active military confrontation and coercive bargaining are not only inappropriate, they are dangerous.

The inexorable internationalization of economic activity and the rapid worldwide spread of technology have also changed the international security threat. Commercial markets are now providing access to advanced technology that enables many states to develop sophisticated weapons programs if they so choose. Though none could readily match the current U.S. capacity for conventional power projection or for strategic nuclear operations, many could plausibly aspire to negate our conventional capabilities in local areas. They could also offset them with long-range strategic assets more limited in size. The pattern of long-term military investment is therefore of more concern to the United States than immediate operational threats. Induced restraint is our fundamental interest. It would be a serious mistake to promote a traditional pattern of competitive national investment in which a number of countries begin implicitly to design their capabilities against U.S. forces.

Beyond Confrontation to Cooperation

Taken together, these new developments require a change in the fundamental principle on which the United States bases its security policy. The current defense program seeks to continue a strategy of active military confrontation against no one in particular and therefore against everyone in general. The more appropriate alternative would shift to a principle of cooperative engagement, in which the United States seeks to regulate, by mutual consent, the size of force deployments, their operational practices, and their investment patterns.

Cooperative security is a principle the United States developed successfully with the German and Japanese military establishments after World War II. By internationalizing their security, we internationalized our own. We are now in position to extend that basic principle to the military forces of the new Commonwealth and ultimately to China as well. Cooperative engagement offers a way to prevent major war and to control weapons proliferation. It would also provide a legitimate basis for continuing the *de facto* advantages the U.S. military establishment now enjoys.

If we are to induce restraint and promote effective cooperation, we must practice it ourselves. We should reduce U.S. forces in accord both with reduced plausible threats and with a fundamentally new security policy that would develop international arrangements institutionalizing cooperation. For our political system, making the necessary conceptual shift and then developing policy to support it will probably be even more difficult than making the immediate budget reductions. But the job is strongly mandated by circumstance. The new security situation demands that we respond to it with something much more than business (that is, confrontation) as usual. ■

Table 2. Defense Plans Compared by Major Programs

(BILLIONS OF 1992 DOLLARS)

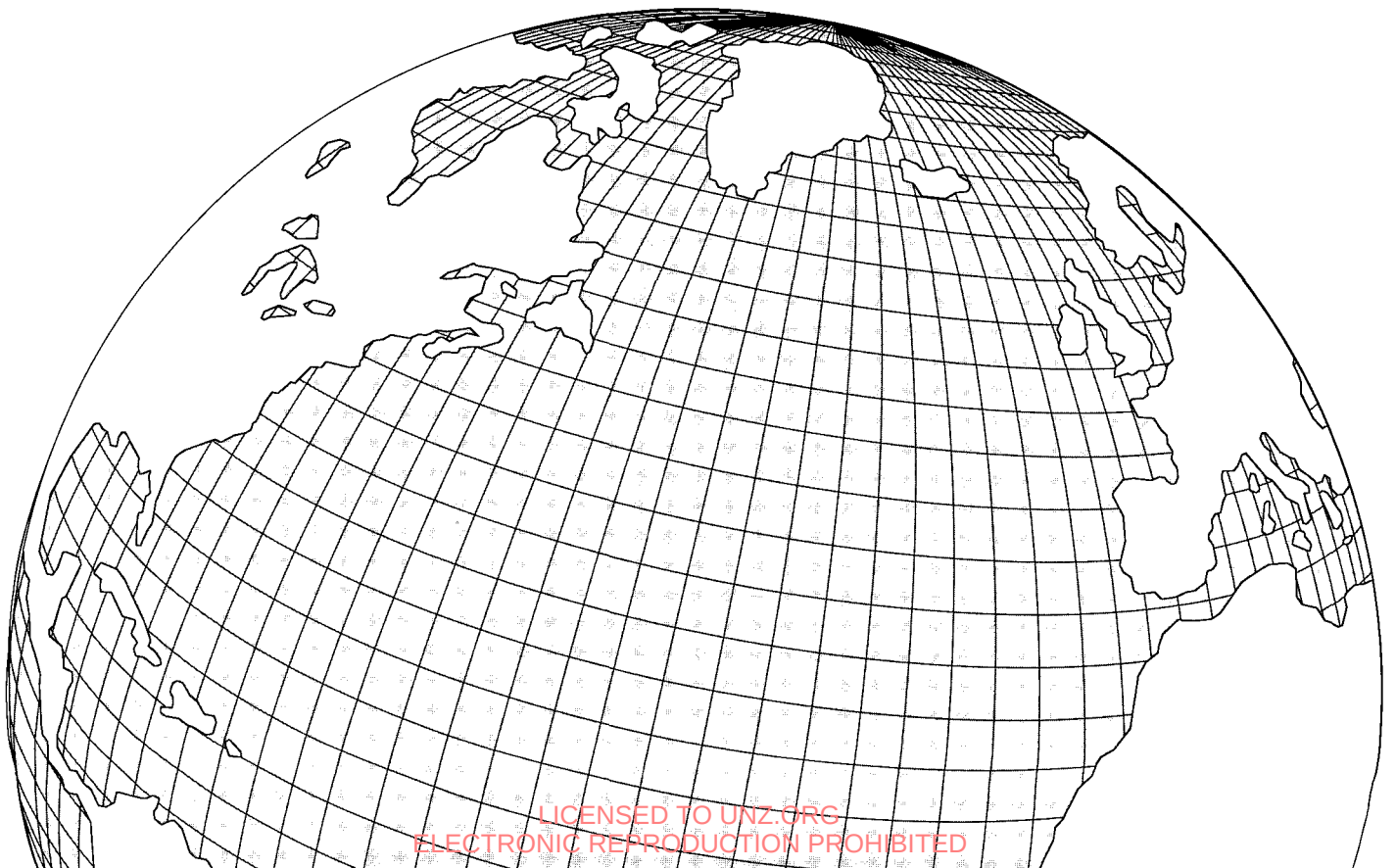
PROGRAM	ADMINISTRATION PLAN		COOPERATIVE SECURITY PLAN	
	1990	1996	1996	2002
STRATEGIC NUCLEAR	48.2	37.3	20.0	14.7
THEATRE NUCLEAR	2.4	1.4	—	—
GROUND	86.8	54.3	40.1	30.1
LAND-BASED TACTICAL AIR	63.5	42.0	41.5	32.0
NAVAL	83.0	67.0	47.2	39.0
AIRLIFT AND SEALIFT	13.4	12.8	13.4	13.4
INTELLIGENCE, COMMUNICATIONS	19.2	18.4	17.9	17.6
TOTAL (051)	316.5	233.2	180.1	146.8

Source: Testimony by John S. Steinbruner before the Senate Appropriations Committee, February 19, 1992. Figures include the Department of Defense (051).

J A M E S S C H L E S I N G E R

THE TRANSATLANTIC PARTNERSHIP

An American View



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The stirring drama of the changes in the East and the lesser (though still impressive) drama of steps toward greater European unity have so captured the attention of the West as to overshadow the issue of how U.S.-European relations will change as a result. Indeed, to the extent that the question has been addressed at all, it has been almost as an afterthought.

Massive changes in the structure of international politics inevitably bring important adjustments, some of which are unforeseen. It takes many years for such adjustments to take place and often more years before they are broadly acknowledged. Such is likely to be true for U.S.-European relations in the aftermath of the Cold War.

It is particularly likely to be true on this side of the Atlantic, for the collapse of the Warsaw Pact, the withdrawal of Soviet forces from Eastern Europe, the end of the Soviet threat, and, indeed, the disintegration of the Soviet Union must ultimately mean a lessened role and lessened influence for the United States in Europe. Americans will be inclined to reminisce about the glory of Cold War days and will be slow to acknowledge America's diminished status. Europeans, understandably delighted by the end of the division of Europe and of the residue of World War II, will be far quicker to recognize these changes in the U.S. role, but for reasons of gratitude, diplomacy, or tactics, they will be disinclined to stress so fundamental a change in the relationship to their American brethren. However, time and the unfolding of events will make that change increasingly evident to the discerning.

For the moment, the catharsis reflecting the Western (largely American) triumph in the Cold War—along with the preponderant American role in the Gulf War—has tended to obscure the immense changes already in train. Nonetheless, the prospects for U.S.-European relations involve two fundamental facts. First, ultimately the realities of the changed political and economic lines of forces will outweigh all the immediate declamations of unswerving mutual loyalty, or of fidelity to institutions like NATO. Second, the sharply diminished need for U.S. protection unavoidably implies a shrinkage in the U.S. importance to Europe. That will be true no matter how much we flatter ourselves (and the Europeans flatter us) regarding our being the “sole remaining superpower.” A military superpower simply cannot deal with numerous adjustments—almost all modest, if not Lilliputian, in scope. A superpower is essential only for *major* military tasks, such as deterrence. With the end of the Soviet threat few such tasks remain and fewer still that Europeans cannot handle on their own or for which the United States is essential. For some of those tasks—providing massive economic aid to enable Eastern Europe to make the transition from communism, for example—the United States has shown little appetite for participating in a large way.

The outcome is easily predictable. U.S.-European relations, while remaining generally warm, will grow somewhat more distant and far less intimate. Increasingly the European nations will go about their business with less and less reference to the United States.

The European movement toward “ever closer union” will continue apace, though far more gradually and with more setbacks than the enthusiasts will concede. Americans will continue to offer advice, some solicited, some unsolicited, but increasingly that advice will be shrugged off. Indeed, even in the past three years, American advice has frequently fallen on deaf ears.

From time to time this newly manifested European independence has caused irritation and shock in Washington. The irritation is understandable; the sense of shock is not. It is scarcely surprising that Europeans regard developments in Eastern Europe, say, as matters that they are far more knowledgeable about and that are far closer to their interests. On such matters as the recognition of Slovenia and Croatia, they are likely to regard American advice as having a far-off, if not academic, sound. To be surprised by such attitudes reflects our own innocence and vanity.

To some extent the new European freedom to focus on distinct, as opposed to common, interests is desirable. It is one of the benefits of the virtual elimination of the common security threat. For 45 years the main task of American foreign policy has been to allow the Western European states to flourish without interference from the East. Surely our success in achieving that long-time policy goal ought not make us too despondent.

A Lost Opportunity

Though to some degree this greater European independence was unavoidable, to some degree it was not. The United States and Europe need not have faced this prospective distancing if both had worked harder during the Cold War to build common institutions. Take, for example, the famous (or infamous) “year of Europe,” which Secretary of State Henry Kissinger attempted to launch in 1973. No doubt the phrasing was unfortunate and the preparation inadequate. But the purpose of the endeavor was grossly misunderstood in Europe. Kissinger's motive was a noble one, in part reflecting his position as an American of European birth. What he hoped to do was to cement relations through institutions that would survive when those Americans who had worked so long and closely with Europe and Europeans and had emotional ties were no longer on the scene.

Regrettably the effort proved abortive. The European nations were generally suspicious of American motives, rather unjustly so in view of Kissinger's high purpose. The timing was clearly unfortunate. Many in Europe had been distressed by the American involvement in Vietnam. Some, and a steadily growing number, were increasingly disturbed by the unfolding Watergate affair, which was to reach a crescendo in the following year. And, finally, the Western alliance was shortly torn by dissension during and after the Middle East war in the fall of 1973.

To have created institutional arrangements then would have established a more permanent bond between Europe and America. Unfortunately the opportunity was lost. Now, two decades later, it is no longer

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possible to forge so close a bond. We shall have to settle for less. Warm relations will continue for the most part, but there will not be institutional arrangements that go beyond NATO, designed primarily to provide military security rather than a permanent political bond.

"The Moving Finger writes, and, having writ, / Moves on." What will the future of U.S.-European relations be?

Security Arrangements

For almost 45 years security has been the crucial element in the U.S.-European relationship. Deterrence provided by the United States has been the glue holding the alliance together. Up to the end of World War II American leaders, including President Harry Truman, believed that the European states could work out their destinies on their own—and that after the war the United States could essentially "go home." But the Soviet takeover of Eastern Europe, the communist danger within Italy and France, the coup in Czechoslovakia, the Berlin blockade, and, in 1950, the invasion of Korea destroyed that comforting illusion. Countering the Soviet power that threatened a divided and weakened Western Europe would require the continued involvement of the United States. American forces returned, in number, to Western Europe and have remained ever since. NATO was created and has served as the embodiment of mutual security. Europe, under the protection of an ever more sophisticated U.S. nuclear deterrent, began to increase its contribution to the common defense. West Germany was embraced within the alliance, and German rearmament was launched. As Soviet capabilities increased, NATO doctrine was slowly adjusted. Flexible response, a robust conventional capability, and later the threat of selective nuclear strikes became integral to an increasingly sophisticated NATO deterrent.

Now the security issue has been fundamentally altered. The external threat has largely evaporated. The Warsaw Pact has disappeared, and the residual Soviet threat has largely disintegrated. The need for massive security forces and complex security arrangements has correspondingly abated, weakening the glue that has held the alliance together. Consequently, the question has grown increasingly pressing: what is to succeed the security arrangements in providing the glue that maintains American involvement in Europe? It seems fair to say that this fundamental question has not been addressed with any urgency. The clear tendency has been to rely on momentum, and to hope that the legacy of the past will be sufficient. Just as was true after World War II, it will probably take some years before an answer is sorted out.

The eruption of the Persian Gulf crisis in August 1990—while the Soviet Union still appeared to possess unity and much of its global power—led briefly to a hope in President Bush's "new world order" as a continuing bond for members of the Western alliance. The phrase had a good wartime ring to it—and might sustain American engagement for the indefinite future. Perhaps to European ears it sounded a bit Wilsonian. Over the years Europeans have either become inured to or learned to be patient with these waves of American enthusiasm. (One recalls Clemenceau's weary reaction to Wilson's Fourteen Points: "Fourteen," he mused; "the Good Lord required only ten.")

But the new world order faded quickly as a substitute

for the security arrangements designed to cope with the classic Soviet threat. The Soviet Union, initially intended as one of the two superpower pillars of the new world order, soon collapsed. Moreover, the Bush administration itself quickly lost interest in and ceased to advertise the concept. Perhaps it had come to recognize the futility or the costs of coping with the chaos that marked the old Soviet empire, the Middle East, and much of the underdeveloped world. In any event, European skepticism about how orderly the post-Cold War world could be made to be was never put to the test.

NATO: Rapid Reaction

NATO and its component military establishments quickly recognized that neither the Warsaw Pact nor the Soviet threat could any longer provide a foundation for NATO force planning or strategy. Consequently, they quickly recommended far smaller and more mobile forces, designed for crisis management, with a much reduced U.S. component. They planned to construct a multinational Rapid Reaction Force, under the command of a British general, to respond quickly to crises that could not be predicted in advance.

Whether this plan is the basis of a permanent substitute for NATO's old role against the Soviet threat, and particularly one that can retain American involvement, remains to be seen. Clearly the first such crisis, the one in Yugoslavia, with the manifest American unwillingness to get directly involved and with the focus for a solution on the United Nations rather than on NATO, raised some question about the long-term adequacy of the suggested solution. In the end, it may wind up appealing only to the military establishment itself. Nonetheless, the military is to be commended for its quick recognition of the obsolescence of its time-honored force planning and doctrine, and for its imaginativeness in proposing a plausible change.

The Pentagon: Clinging to the Past

The United States was somewhat slower to change and somewhat less imaginative. The U.S. Department of Defense tended to cling to the threat from the East up to the point of its evaporation. Here we were alone among our allies, who far more quickly recognized that the threat had largely disappeared. (In this regard things are not so much different from the past, for the European allies habitually took the Warsaw Pact threat far less seriously than the Americans did.) But surely even the residual historical threat becomes undermined, if not meaningless, when Russia itself asserts that it wants to join NATO.

We have also regularly claimed that the American presence and American leadership, as well as a vibrant NATO, will be required to cope with uncertainties and to prevent instability. Yet when the chaos and violence in Yugoslavia provided a first, rather dramatic example of such instability, Americans quickly declared that coping with the Yugoslav situation was up to the Europeans. Although I personally think that the U.S. decision was correct, the fact is that this *political* decision undermined our own more general argument for the continued role for our forces in Europe.

The Defense Department hopes to maintain, after the drawdowns, a force of 150,000 troops in Europe, including an Army corps in Germany. It remains to be seen whether Congress will be prepared to support so large a U.S. pres-

ence in Europe. Equally important, we do not yet know whether the Europeans, and particularly the Germans, will be prepared to tolerate so large a force on their soil for the indefinite future, particularly after all Soviet troops are withdrawn. The Kohl government is likely to be the most pro-American government we will ever see in Germany. But even that government has its own way of asserting its independence. To Washington's publicly expressed irritation, the Kohl government did not even answer the phone to take our frantic messages regarding the intended German recognition of Slovenia and Croatia. It seems to me most prudent not to set our aspirations for eternal friendship too high. Europe is likely to have its own and changing ideas about the size and composition of a residual American military deployment.

There is a significant risk that the United States will be seen to be clinging to the past. We have repeatedly insisted that the role of NATO will be transformed but not substantially reduced. We have been more or less open about the reason for our insistence on a large continuing role for NATO. It is the only European table that provides a continued American seat. But surely we should recognize that the European view of our role will be different from ours—and European enthusiasm, particularly in some nations, discernibly less. In brief, Americans continue to talk as if the important structural changes that we nominally acknowledge will have no real impact. The great mission for NATO is largely gone. While NATO will continue to have a significant political-military role, it will inevitably be smaller than it has been in the past. To pretend otherwise merely weakens U.S. credibility.

At the Rome summit last October, President Bush urged our European allies that if they had doubts about the long-run U.S. role in Europe and believed it to be "superfluous," they should tell us now. To pose such a challenge in itself shows our own doubt about what our relationship to Europe should be. Moreover, it is unrealistic to expect the Europeans to declare *now* how they want the U.S. role in Europe to change. They do not know yet. Only time and unfolding events will determine and reveal what the Europeans collectively really want in the future relationship.

The United States has repeatedly expressed its apprehensions about European movement toward a more unified European military force. We have regularly expressed suspicion, no doubt excessive suspicion, about any serious moves toward Franco-German military integration. This I think is a mistake. In the first place, the degree of European military unity will be largely determined by internal dynamics, and will not, in any event, be much influenced by American expressions of concern. In the second place, we should bear in mind that for many years we have pushed the Europeans toward greater military cooperation. Four decades ago the United States strongly urged the establishment of the European Defense Community, and we were deeply disappointed when it was finally scuttled, under the Fourth Republic, by the French parliament. The Western European Union was then designed as a substitute for the EDC. If we then wanted the greater vehicle, we should not now object to the lesser vehicle. The WEU seems a highly appropriate vehicle for the pooling, to whatever extent the Europeans ultimately agree, of their military forces. It would be ironic if Amer-

icans now came to resent the achievement of their own long-term objective of greater European military integration. Admittedly the WEU may be a symbol that the United States has become less needed than it was during the Cold War. But if we wish to retain our influence in Europe and a continuing role in European security, we cannot afford to be churlish.

Apprehensions about Economic Change

Just as concern about the common defense tends to be cohesive, so trade issues tend to be divisive. As worry over security diminishes, attention increasingly shifts to economic issues, which are less likely to unite the United States with than to divide it from the increasingly unified Common Market.

The question has grown increasingly pressing: what is to succeed the security arrangements in providing the glue that maintains American involvement in Europe?

Examining how economic issues will affect the U.S.-European relationship requires assessing the impact of the single market, which will permit the free movement of trade and people. For the most part the movement toward a single market involves European decisions and European consequences that others are in a better position than I to discuss. All I can do is to offer an American view on this primarily European development. Suffice it to say that the United States has been far more concerned about the impact of "Europe 1992" and the single market than it has been about security or political issues. Americans have been highly ambivalent, at best, and apprehensive or hostile, at worst, about the effect of 1992.

My view is that the attention devoted to and concern expressed about 1992 has been grossly disproportionate to

its overall effect on the American economy (not to mention the degree to which Americans can influence decisions taken in Europe). We should not allow our apprehensions to get out of hand. Once again, it is important to bear in mind that for many years the United States has strongly encouraged the movement toward European economic integration. Here, as with security matters, it would not be fitting for us to appear churlish when the objectives for which we have long striven are finally achieved.

This is not to say that I think the impact of the single market will be inconsequential from the standpoint of specific American industries. Almost unavoidably the single market will be a vehicle for joint discrimination against the United States. One may accept European assurances that there is no desire or intention to create a high-barrier

Nonetheless, the higher relative barriers will encourage both to produce in Europe.

The net effect will be to encourage international investment and to discourage international trade. This certainly does not imply that international trade will fail to grow, but it will grow less than it would have otherwise. It will be discouraged by the muting of the effects of price and cost differences but will undoubtedly be encouraged by the growth of income.

The task for the United States in these circumstances is to prevent the discrimination from getting out of hand, to discourage any increase in the absolute level of trade barriers, to avoid getting too stirred up by the horror stories to which individual industries will point, and to avoid a general trade war. We must retain a sense of proportion. Despite all the chatter, the consequences for the United States of the move to a single market are far less dramatic and far more favorable than many in the political-military realm.

Moreover, changes will likely be far less immediate and far less extreme than advertised. Progress in practice will be slower than on paper. The expansion of the Common Market—to include Austria and Sweden at an early date and others later—will mean some sacrifice of the intensity of market integration.

Inevitably jealousies will continue to exist in Europe. There will be squabbles over the “cohesion fund.” The poorer nations of southern Europe will argue that the fund is much too small. The richer nations of the North will be alarmed by and will probably resist the movement of industry toward the lower-wage South. Britain will prefer to move at a slower pace than the others and will have to be dragged along.

All the nations involved are democracies, sensitive to the concerns and interests of their own voters. They will be jumpy about any threat to older industries that causes a serious loss of jobs or income. Democracies are far better at creating, through direct or indirect subsidy, new industries (such as high tech) than they are in allowing older industries to decline without resistance.

The upshot is that Americans have less cause for apprehension than is frequently suggested. So long as no gross trade imbalance exists between the United States and Europe, the single market should not cause any changes with which we cannot live comfortably. No doubt adjustments will be required, but they will be no greater than a healthy American economy can readily accommodate.

On balance, therefore, we would be wiser to turn our attention to our own self-inflicted problems. The low rate of domestic saving, the modest level of domestic investment, the slow growth of productivity, particularly relative to Germany and Japan, the budget deficit, the trade deficit, the weaknesses of our system of primary and secondary education, all these antedate Europe 1992. If we want to improve economic performance and move toward restoring American economic leadership, we need to attend first to our internal problems.

The United States of Europe

Since Marshall Plan days, some 45 years ago, the United States has more or less regularly supported the move toward greater political unity in Europe. The U.S. public generally harbors few of the misgivings that some may express about the effect on the United States of European

The danger for Europeans, given America's domestic travails, is that they will be too dismissive of the United States and therefore of the value of the U.S.-European partnership.

Fortress Europe. That barriers may be no higher in absolute terms does not mean they will be no higher in relative terms. After all, the purpose of the single market is to eliminate internal barriers, which inherently means increased joint discrimination against the outside world. Moreover, the process of negotiation and accommodation will normally be at the expense of those who do not have to be accommodated.

For years Europeans have expressed their frustration at their weakness relative to the United States and Japan in high-technology industries. Now that internal barriers are being removed, it would be surprising if Europeans did not seize the opportunity to foster technology and engage in joint discrimination against the outside world. To be sure, the United States is likely to be far better treated than Japan.

economic unity. To most Americans, who from time to time wonder what all the quarrels in Europe have been about, a movement toward a United States of Europe seems patently desirable. By and large, U.S. policy has regularly pressed in the same direction. In the 1950s and 1960s the U.S. government was frustrated by Britain's reluctance to cast its lot with Europe and consistently prodded Britain in that direction. It was later exasperated by Charles de Gaulle's veto of British entry into the Common Market. Indeed, the United States has been more consistent in its support of greater political unity in Europe than have several European countries themselves.

On the other hand, there was always a minority of senior officials and their advisers who, whatever lip service they might render to European unity, questioned whether it was desirable from the American point of view. They felt that the European states would gang up on the United States, decide among themselves on a common policy, and present the United States with a *fait accompli*, so that U.S. influence and leadership would inevitably be weakened. Yet real hostility to serious efforts toward European political unity was rare. By and large, most officials as well as the public have over the years been consistent supporters of the move toward European political union.

Now that the movement seems to be heading toward fruition, more second thoughts are arising. Quite rightly the Maastricht summit last December made Americans ponder the future of Europe and U.S.-European relations. But Maastricht also set off alarm amongst those who fear greater European political unity, a common economic policy, or the movement toward a common European defense that might diminish NATO.

In my view such fears are not worthy of this country. We are on the verge of achieving political objectives that we have supported for many years. Just as victory in the Cold War represented a triumph of American policy, so the movement toward greater unity represents a triumph not only of European policy but also of American policy. Maastricht lay down a blueprint: for a single currency, for a Central Bank, for a common foreign policy, and for a common social and economic policy. These are goals to be achieved within this decade, although Britain has publicly reserved its options.

Surely we should welcome these changes, though it is no longer our task to urge the European states to proceed more rapidly than they themselves determine. Surely the United States has been frequently enough called on to intervene in Europe's civil wars to make us duly apprehensive about differences within Europe. The present movement reduces to an insignificant level the risk that Europe might once again engage in civil war.

Nor should we expect squabbles to cease. The European "nation" is somewhat like the Arab nation in that its unity is far easier to conceptualize than to achieve. In practice, Europe is likely to conform to de Gaulle's vision of "Europe of the Fatherlands." Former prime minister Margaret Thatcher is but the latest of European leaders to resist the loss of national sovereignty. Such attitudes are not likely to disappear soon.

Differences among the major powers will be difficult to resolve. The economic tensions mentioned earlier will also be reflected in the political dimension, especially between the rich and the poor nations. Germany's neighbors are

likely to view that country with trepidation as its relative power grows and as the process of absorbing the former East Germany is completed. In short, the process of unification will go on for decades. Americans should support it. From our standpoint it does not represent a clear and present danger.

In part, Americans tend to sympathize with the perplexities of their long-time British ally. The British dilemma is no doubt acute. But despite their hesitation, not to say recalcitrance, the British recognize that in the end they have no choice but to go along. This fact is well understood on the continent. It was Jean Monnet, derisively referred to by de Gaulle as the "Father of Europe," who observed during similar circumstances in the 1950s: "Don't worry about the British. Nobody can better recognize a *fait accompli* when they see one. . . . They'll run and catch the bus at the last possible moment." For what is the alternative? If Britain were to stand aloof, it would allow its influence in the new Europe to shrink.

Europe's future problems will probably be less and less those of a traditional sort. Demographic trends reveal quite starkly that the West in general, and Europe in particular, is shrinking relative to the outside world. Western Europe's problem will be that of burgeoning populations along its frontiers seeking to get in. Along the Mediterranean coast this means the Muslim peoples of the Maghreb, Egypt, the Levant, and Turkey. For Germany it is likely to mean a continued pressure for immigration from the states to the east, perhaps particularly from the former Soviet Union. Both from inside and from outside the new Europe will face challenges aplenty.

The Year of Europe—Not Quite As Expected

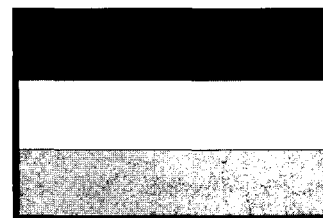
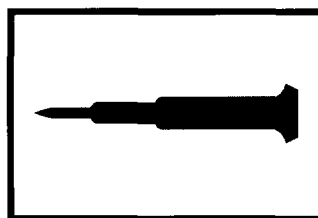
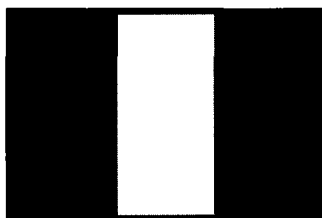
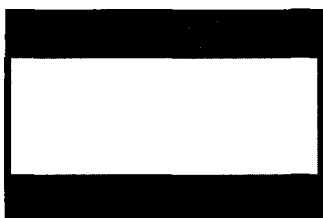
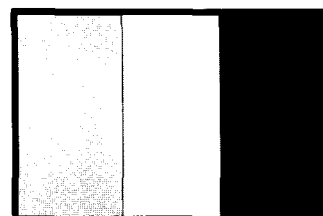
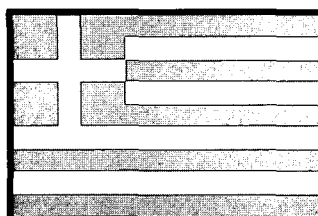
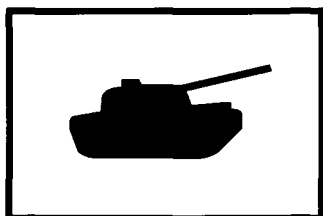
As it turns out, the "year of Europe" will be 1992 rather than 1973. It will be quite different from that which Henry Kissinger envisioned two decades ago. It will be almost all internally initiated, with little sponsorship from the outside; there will be no building of common institutions across the Atlantic. It will proceed further along the path to common policies and toward ever greater union, reflecting greater European self-confidence and greater maturity. It should be welcomed by Americans.

Because of the dominant role that the United States played during the Cold War years, many Americans will inevitably feel some nostalgia for those glory years. When an external threat diminishes, alliances grow less cohesive. Unavoidably, the old order changeth and adjustments must be made. The danger for Americans is that they will cling to the past. The danger for Europeans, given America's domestic travails, is that they will be too dismissive of the United States and therefore of the value of the U.S.-European partnership.

As for the United States, it needs to face up to its long-overlooked social and economic challenges. Unless we effectively grapple with our domestic ills, we will have neither the inclination nor the ability to lead. Indeed, our domestic performance will be far more important in determining our international role than either the single market or Maastricht. And both Europe and the United States must recognize that, despite the radical changes in the structure of international politics and in the U.S.-European relationship, the transatlantic partnership will have abiding value for the future. ■

ARMS SALES

EUROPEAN COMMUNITY EXPORT



As the European Community nears completion of its ambitious single market program at the end of 1992, it faces the politically sensitive task of developing a Community-wide policy governing the export of arms and military-related goods and technologies.

Historically the issue of arms exports has been the province of Europe's national governments. Article 223 of the Treaty of Rome, the EC's founding document, has prevented the Community from developing responsibility in the fields of security and defense (see box). Arms production and export controls have thus been exempted from Community commercial and trade policies, a decision strongly supported by individual governments, particularly those of the United Kingdom, France, Germany, Italy, and the Netherlands, Europe's chief arms exporters.

Completion of the single market, however, is forcing the issue of weapons proliferation onto the Community's policymaking agenda. At the end of 1992, border controls within the Community will be phased out. Customs controls will be carried out only at the Community's external borders. In accordance with the Treaty of Rome, exports of arms and munitions will remain under national control and will still have to be registered with the national customs office even if they are shipped to another EC country. But Article 223 does not apply to an increasing array of goods and technologies, including high-performance computers, precision machine tools, fiber optics, or parts such as microchips, that have both commercial and military uses. Those dual-use goods and technologies will soon be passing freely throughout the Community, able to exit

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Europe through the country with the least effective export controls, thus making other, more stringent controls useless.

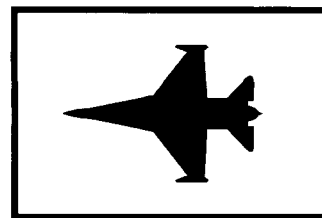
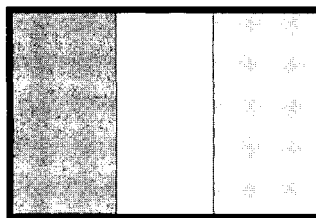
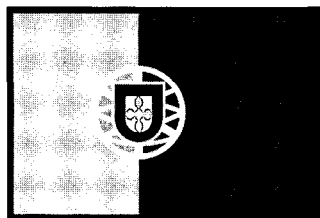
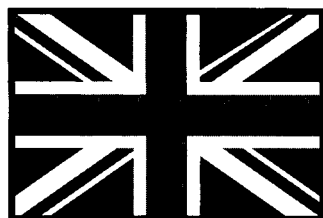
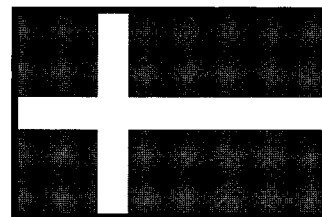
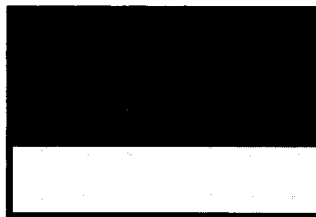
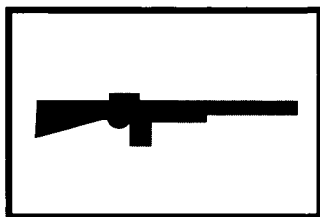
The challenge for the Community is to develop a harmonized list, common standards, procedures, and licensing requirements for exports of dual-use technology, as well as a single country list that prohibits the export of dual-use goods and technology. In addition, it will have to ensure that these standards and procedures can be implemented with equal vigor along the entire outer perimeter of the Common Market.

The European Commission, the EC's executive arm and policy leader, has been working with member states to ensure that all will be able to implement effective controls of "non-Article 223" exports to countries outside the EC by the end of 1992. Because the adjustments have had to be negotiated country by country, the process has been lengthy and difficult. To facilitate the required changes and to execute future policies, the Community considers it essential to establish a forum—an export control committee or possibly even a European Export Control Agency—that coordinates and monitors export controls and establishes a system requiring the disclosure of the end use of dual-use imports and monitoring compliance with end-user certificates.

The export control group would also develop a Community handbook of procedures and detailed guidance on export licensing and serve as a pool and clearinghouse for all licenses applied for and awarded. It would make all necessary reports to international organizations, such as the United Nations arms registry. Finally it would be a source of expert and technical advice for member states.

A B R O A D

CONTROLS BEYOND 1992



Tackling Article 223

Two recent developments have allowed the European Commission to begin to challenge national sovereignty even in the specific area of arms and munitions exports. First, the Persian Gulf War drew attention to the contribution that individual EC governments had made to Iraq's military machine, thus reminding the countries of the limitations of national policies. In its June 1991 Declaration on Non-Proliferation and Arms Exports, the European Council, made up of the leaders of the EC's 12 member governments, identified a set of common criteria upon which "a common approach will be made possible, leading to a harmonization of national policies."

Second, an ongoing intergovernmental conference on Political Union has allowed those countries that favor a Europe-wide, rather than national, approach to put the issue of export controls on the negotiating table for the first time. At the opening session of the conference in Rome last year the governments agreed that "coordination of armaments export policy and non-proliferation" should be considered in the ongoing debate over political (as opposed to economic) union. Seen from this perspective, EC export controls are part of the unfolding implementation of an EC foreign and security policy. The European Council's Maastricht summit last December moved the EC further along that path, and at the upcoming Lisbon summit in June the Commission will present a new set of export control proposals. The Commission has already recommended to the intergovernmental conference on Political Union that Article 223 be deleted, a good indication that powerful forces within the European

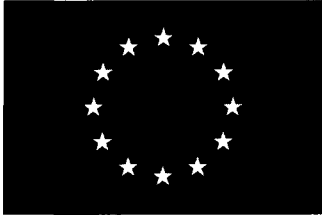
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Council support such a move. In addition, the European Parliament, made up of 516 representatives directly elected by the citizens of the member states, has long backed a Europe-wide regime, whereby security-related exports would be treated like other forms of trade, and the Community would gain complete authority over external trade of all goods.

European arms-exporting nations themselves are split over the issue. France and the United Kingdom argue that an EC export control policy should confine itself to narrowly defined military security concerns. Because the primary threat to the EC comes from four technologies—nuclear, chemical, biological, and ballistic missiles—France and the UK favor an export control policy geared toward those only. Germany, the Netherlands, and Italy, by contrast, would like a broader policy that would include conventional weapons as well. However the disagreement is resolved, it will shape community policy in the future. A compromise measure was tabled last year by the Dutch during their presidency of the Community. In its place, the Dutch offered a proposal that would stop defense manufacturers in general from using Article 223 to avoid EC rules and instead single out specific items they produce. The proposal would leave a very short list of highly sensitive technologies or programs (nuclear weapons and systems, anti-toxic and radioactive agents, cryptographic equipment, space systems) that would remain exempt under Article 223.

An Arms Industry in Transition

Efforts to establish EC control over arms exports have been boosted by gradual changes in Europe's



ARTICLE 223 OF THE TREATY OF ROME

1. The provision of this Treaty shall not preclude the application of the following rules:

(a) No member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of security;

(b) Any member State may take such measures as it considers necessary for the protection of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.

2. During the first year after the entry into force of this Treaty, the Council shall, acting unanimously, draw up a list of products to which the provision of paragraph 1(b) shall apply.

3. The Council may, acting unanimously on a proposal from the Commission, make changes in this list.

defense industry. Until recently, the industry was fragmented along national lines. The result was inefficiencies caused by low production runs, duplication in research and development, escalating production costs, and over-dependence on unstable export markets. In many sectors, the industry simply lost competitiveness, especially with its U.S. counterpart. A few years ago, most European defense firms began to acknowledge not only that the ratio of defense to total production will have to decline significantly in the coming years, but also that global and not European competition is the future for weapons systems producers.

The industry's changed strategic outlook brought on a wave of consolidation. Even before the end of the Cold War, restructuring had begun to transform the industry. European arms producers are now engaged in numerous cooperative projects—the EFA, Tornado, NH-90 helicopter, and the TRIGAT and FAMS missiles. In addition, the number of mergers, acquisitions, joint ventures, and strategic alliances among European firms is increasing rapidly. In Germany, Daimler Benz took over TST, MTU, and MBB; in France, Thomson-CSF and Aerospatiale created a joint subsidiary; in Italy GEC purchased Ferranti Defense Systems. At the European level, Italy's GEC and Germany's Siemens took over Plessey, a British firm; France's Thomson acquired a subsidiary of Dutch Phillips. The decision by Thomas-CSF to shift a missile contract from the U.S. LTV Corporation to Euromissile, its European archrival, also indicates the “Europeanization” of Europe's defense industry. The industry is now likely to perceive a single European market for their products as an advantage and therefore to be less hostile to the Commission's efforts to eliminate Article 223.

The Shrinking Defense Market

The end of the Cold War hastened trends already under way in the industry and gave a further boost to the Commission's export control ambitions. Europe's defense market is rapidly shrinking as governments reduce their defense expenditures—expenditures that account for about 70 percent of the business of Europe's defense industry. National markets are simply no longer large enough to sustain a modern arms industry. Defense manufacturers will also be under increasing pressure to diversify into nonmilitary production, with the result that more and more of their production will fall under current EC (possibly dual-use) legislation. And EC funding for technology programs such as ESPRIT and EUREKA dealing with dual-use technologies is bound to come with single-market strings attached. Finally, increasing cooperation among Europe's scientific community will undermine national industrial strategies that rely on privileged information for competitive advantage.

The continued process of adjustment to new economic and political realities will encourage more cross-border mergers and acquisitions, over which the Commission, through its control over EC competition policy, is the sole arbiter. Recently the Commission approved a \$1.3 billion joint venture between Aerospatiale and MBB that created the world's second largest helicopter producer. Last October the Commission approved the joint electronics venture of the United Kingdom's Pilkington P.L.C. and France's Thomson-CSF, creating a European giant producing optronics equipment.

The Community will have to become even more active if it wants to ensure a continued and smooth contraction of the European defense industry. As the industry faces the prospect of large reductions in size, pressures to export to countries outside the Community are also likely to increase. In turn, incentives for

more stringent export controls are likely to diminish as the industry competes for a constant share in a shrinking global arms market. Moreover, expected cuts of up to 40 percent in the work force in the West European defense industry will create a sizable political constituency opposing tighter controls or any other policy change that may lead to a drop in external demand. In response, the EC must help manage both the conversion and the contraction of the industry. Ideally such a contraction could reduce industry capacity to a level at which European (and perhaps U.S., Canadian, and Japanese) demand alone is sufficient to sustain it. Community policies (and funds) to increase common procurement and to move defense firms into civilian markets could prevent the process from being socially and politically unfeasible. The United Kingdom, France, and Germany, who together account for 82 percent of European defense production, will be most heavily affected.

Curbing the Demand for Arms

In addition to trying to control the *supply* of weapons and weapons technologies at home, the Community is considering ways to reduce *demand* abroad. One important policy option is “conditionality”—making economic aid and cooperation contingent on a country’s willingness both to cut arms spending and to permit international inspection of the industrial application of dual-use technology (technically known as “transparency”). It has long been known that economic aid releases resources for spending in other areas and thus indirectly finances military expenditures. The end of the global superpower rivalry has now made this form of conditionality politically feasible.

Individual EC members have shown an interest in developing a formula for such conditionality. Indeed, a few EC countries have already acted on their own. Germany, for example, has publicly linked its provision of economic aid to the recipient’s military spending policies. Italy has even introduced such criteria into Italian law. Recently the Netherlands, with the support of Belgium and Italy, has reintroduced the concept of “reasonable sufficiency” as a criterion for controls on arms exports: constraints would be placed on arms sales to states that maintain forces far in excess of those necessary for self-defense. Another approach is to determine whether arms sales are compromising the human and economic development of an importing country. That approach, however, requires comparing a country’s spending on military goods with its spending on such items as health, education, and the environment, the practical difficulties of which have yet to be surmounted. Another attractive concept of conditionality would be debt reduction—that is, “debt for transparency” or “debt for arms.”

The EC, however, would not act unilaterally in implementing conditionality even if it had the political power to do so. If it did, European industry could lose business to suppliers in other countries. Rather, the Community and its individual members will use their influence in international organizations to press for a broad-based multilateral approach. Not only is such an approach likely to be much more effective, but also it will provide the “level playing field” that will secure support from European industry.

The Community is still too weak an actor on the global political stage to exercise effective pressure on international organizations to endorse new concepts of conditionality. With the progressive emergence of a unified European foreign policy, however, this is likely to change. The increasing political weight of some individual European countries and of Japan, which has

also linked its aid to a review of military spending in the recipient country, has already generated some results at the global level. Several international organizations have expressed interest in linking economic aid with military spending or compliance with international nonproliferation agreements. The International Monetary Fund remains committed to the primacy of the traditional objectives of conditionality—balance of payments adjustment and price stability. But the IMF now lists “secondary objectives” that include poverty alleviation, the environment, and containing military expenditures.

The EC—Case Study of a Global Regime?

The EC’s experience in implementing a supranational dual-use export control regime among sovereign states offers valuable insights for the architects of such a regime on a global level.

Just as the Community is having to grapple with export control problems arising from the fall of internal barriers to trade, the world as a whole is discovering that national borders are increasingly ineffectual as an instrument of export control. The progressive globalization of the world economy, the increasing importance of dual-use technology, and the flow of knowledge and information in the form of data and human capital all make it next to impossible to deny access to goods that can be used for military purposes. The alternative—tracking the source and regulating the end use of those goods through a program of transparency—is currently being discussed actively in the Community.

The Community also has to cope with the challenge of substantial differences in the resources available to national control authorities. Greek customs authorities, for example, do not have ships or airplanes. The same problem, on a greater scale, will arise at the global level. One of the great challenges for any global regime will be to enable each member nation to execute effectively the regime’s norms and standards. The Community is preparing to manage such a program on a smaller scale.

Another issue that a global regime will have to tackle is how to divide labor between national and international authorities—again, an issue the Community is currently confronting.

Clearly, the challenges in establishing a global regime are much greater than those the EC now faces. And the architects of a global regime will not be able to rely on the existence of a relatively homogeneous group of countries with the same political systems, similar levels of economic and technological development, and above all, the political will to cooperate closely on this issue. All these difficulties mean that a global regime will take years to put into place.

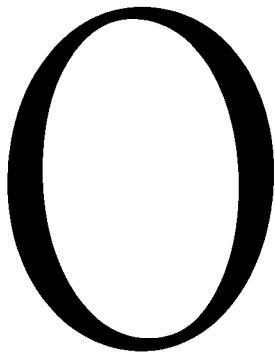
In the meantime, the United States and the European Community should join together in a fundamental overhaul of the Coordinating Committee on Multilateral Export Controls (CoCom), the current Western regime. Designed by the United States and its allies after World War II, CoCom’s aim has been to keep arms and arms-related technologies out of the hands of the Soviet Union and the Warsaw Pact. The recent proposal to incorporate some East European and CIS countries into CoCom is an important step in the right direction and reflects the urgent need to integrate them into the European and world economies. Not only has the end of the Cold War transformed the threat against which those export controls have been directed, but also the European and international economy are undergoing a fundamental transformation that makes traditional export control regimes in their present form redundant. In fact, the EC is not even a member of CoCom and would be unlikely to join it if its principal goal remains the denial of advanced technology. ■

The Winnable War

How Communities Are Eradicating Local Drug Markets



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caine labs, seizing boats on the high seas, attacking money laundering schemes, and even by invading a foreign country. At home, politicians have called for more jails, better drug education, federally funded drug treatment, improved schools, and a return to basic family values.

The combination of all these tactics appears to be slowly working. Although marijuana was openly smoked in Lafayette Park across from the White House in the 1970s, it is now rare to see anyone smoking marijuana on the street. And although drug use steadily increased during most of the 1970s and early 1980s, the *National Household Survey on Drug Abuse* reports a 50 percent decline in monthly drug use between 1985 and 1990.

Yet community concern at the grass roots level has escalated consistently. The reasons for this are as current as this morning's headlines. Into once thriving neighborhoods has crept a culture of fear, with children sleeping in bathtubs to avoid stray bullets, old people afraid to walk to the store, and parents afraid to send their children to the park because of the litter of crack vials and spent syringes.

In hospitals across the nation thousands of drug-damaged infants languish in neonatal wards. Brazen street drug dealers, with gold chains on their necks and telephone beepers affixed to their side, make a mockery of every anti-drug message our children hear in school, at home, in church.

Though public policy generals cite statistics to show we are winning the war on drugs, the foot soldiers on the front lines are cynically skeptical. For them, the issue is not the number of drug users in America, but the proximity of drug dealers to their bedrooms, school rooms, and board rooms.

Defining the Problem

The number of street drug markets has exploded since the introduction of PCP and crack cocaine in the early and mid-1980s. Combined with the entry of new ethnic and youth gangs, these street markets have become pervasive, unstable, and violent. The result has been a rapid deterioration in law and order in America's largest cities. A whole new set of pathologies, unimaginable just 10 years ago, has risen to the forefront of the national consciousness: drive-by shootings, generalized community terror, and a rapid decline in urban property values.

Although illegal drug use, at some level, is here to stay, there is nothing inevitable about street drug markets. They scarcely existed 15 years ago. In the mid-

1970s drug users relied on a private referral market where sales took place indoors between people who had at least a passing acquaintance with each other. These markets were (and still are) rarely violent, do not tempt children or recovering addicts, and do not depress local housing markets.

By eradicating street drug markets, communities can go "back to the future," when drug sales resulted in little collateral damage to residential neighborhoods.

Drug Markets: How They Work

The open-air drug market or crack house is the 7-Eleven of the drug trade, making up in quantity of transactions what it misses in size of sales. While a drug dealer in the private referral market may make just a few sales a week, a drug dealer operating in a street market or crack house may make dozens of sales in a single day.

To make so many sales, street drug dealers must have many customers and make sales quickly. They must effectively colonize specific locations so that customers can, with some degree of confidence, keep returning to buy drugs. Dealers know that if they change location they cannot easily advertise the move and so will lose customers.

Street drug markets are also highly specialized. By selling just one drug at a known price (such as vials containing \$20 rocks of crack cocaine), dealers can make sales without making change or even much conversation. A street drug sale can be completed in less than 10 seconds.

Most neighborhoods, including poor, urban, minority neighborhoods, are not plagued by flagrant drug dealers. The reason is simple: a thriving street drug market operation requires a particular kind of neighborhood, usually one that has four distinct characteristics.

First, drug dealers are not interested in setting up shop in clean, well-lighted neighborhoods with strong community associations. They know such communities will not tolerate their activities. Instead, dealers gravitate to neighborhoods with poorly maintained yards, abandoned cars, overgrown lots, and poor street lighting—obvious signs that a community is poorly organized to defend itself against street dealers and has already accepted a certain level of disorder.

Second, drug dealers need a legitimate cover for their presence on the street. It can be a bar, a restaurant or convenience store, a school or housing development, or even a car wash. When people are naturally coming and going from an area, drug dealers are better able to blend into the crowd and post a legal defense if arrested.

Third, drug dealers are drawn to poor communities that frequently have large numbers of poorly supervised children. These children, hungry for money, are easy to recruit as lookouts and salesmen. If arrested, they are likely to get off with little more than probation.

Finally, drug markets are dependent on a steady stream of customers and a means of quick escape. Markets are usually accessible by car, with dealers naturally gravitating to locations where police patrols can be spotted at least a block away. When the police show

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Guide to Eradicating
Street Drug Markets
(1991).*

up, dealers want to exit quickly—into nearby housing developments, bars, or other hard-to-reach areas.

If a neighborhood has these characteristics, a drug dealer will probably test the local business waters. If not, he will probably pass on by.

Why Conventional Enforcement Isn't Working

The traditional police response to street drug markets is to send in undercover officers to buy drugs and arrest the dealers. But despite their popularity, buy-and-bust operations alone almost never break the back of an entrenched drug market. As long as customers keep coming to a known drug market location, the market is able to recruit new dealers.

Buy-and-bust arrests present the same kind of minor logistical problems a suburban shopping mall faces when labor force turnover is unusually high. As long as customers keep coming, both the drug market and the shopping mall will attract new workers and continue to do business with scarcely a hitch. Even if arrested, street dealers will, as a rule, suffer nothing more than inconvenience. Because of court and jail overcrowding (in part due to buy-and-bust arrests), most street dealers will receive little or no jail time even if they have previously been arrested for misdemeanor drug sales.

Yet despite its ineffectiveness, surveys indicate that the buy-and-bust operation is the only anti-drug-market technique used regularly by big-city police departments. Its continued popularity stems from both internal and external police evaluation systems. Individual officers regularly visit “drug holes” to make arrests in much the same way a fisherman will visit a proven fishing hole. In addition, highly visible buy-and-bust campaigns show public, press, and politicians that “something” is being done to counter the epidemic of drugs and violence in the streets. Like generals in a conventional war, police use “body count” statistics to show that the war on drugs is being won and that more officers and bigger budgets will be needed to wage an even more effective campaign.

Getting the police to abandon buy-and-bust techniques will require changing the way police are evaluated. One step, which some cities are beginning to take, is to stop grading officers and units on the number of arrests made and instead hold them accountable for the number of street drug markets in their area of patrol. For Tampa, Florida, this simple step helped cut drug markets 95 percent (see sidebar).

Tampa is not alone in its success. A Charleston, South Carolina, program designed to cripple the mechanics of street drug sales drove dealers out of town—and into nearby North Charleston, where local police cling to the old ways of doing business. In Chicago, drug dealers were systematically denied access to public housing, and gang-plagued high-rise developments began to turn around after more than two decades of combat-zone conditions.

These examples of success are islands in a sea of generalized failure. In the nation's 15 largest cities police report more than 1,500 flagrant or open-air drug markets. Three-quarters of responding police departments report that their local drug market problems are getting no better or are getting worse.

Yet failure is not universal. What are successful communities doing that the others are not?

Broadcast Intolerance for Drug Activity

Police action can temporarily clean up a neighborhood. But to drive drug dealers and buyers away from an entrenched market, the community must show it is willing to pick up where the police leave off. Drug dealers must believe that they are fighting not just the police, but an entire community.

Organized community patrols, identified by a common hat or T-shirt, and armed with walkie-talkies, clip boards, video cameras, and bull horns, have successfully broadcast community intolerance for drug sales in Washington, D.C., New York City, Philadelphia, and dozens of other cities. Citizen patrols use positive moral force, backed up by the implied threat of police action, to drive drug dealers and their customers out of residential neighborhoods. When citizen patrols record license plate numbers and videotape drug sales, dealers and their drive-through traffic generally beat a hasty retreat.

Community clean-up programs are also important. By removing abandoned cars, installing street lights, clearing abandoned lots of brush and trash, and sweeping streets and alleys, a community signals that it is willing to defend its space. In Tampa more than 80 tons of trash were hauled out of a single community in one day, thereby depriving dealers of places to stash drugs. Noted one amazed resident, “Getting rid of drug dealers is just like getting rid of rats: once you put the trash in barrels and haul it away neither one feels comfortable anymore.”

Neighborhoods Can Reclaim Marketing Space

Street drug markets and crack houses require a stable location. If they move, they cannot advertise their new addresses to existing customers, and so market efficiency declines. The more often the market must move, the less likely it is to return a profit and stay in business.

As many as four steps may be necessary to force dealers to move. First, community leaders should examine the sales location itself. Can it be abolished through eviction, a property closing, a property seizure, or by razing an abandoned and unsalvageable building? If so, they should talk with local property managers, housing inspectors, the city council representative, or the city attorney responsible for property seizure.

Second, leaders should examine customer and dealer entrance and escape routes. If the drug market is in a public housing development, the aim is to keep nonresident dealers and customers out of the buildings. In Chicago, legislation requiring residents to be listed on the lease and to carry a photo-ID card to gain entrance helped prevent nonresident customers and dealers from entering the buildings and using them to conduct business and escape police.

Third, it may be necessary to enact legislation to outlaw the mechanics of street drug sales. In Tampa and in Tacoma, Washington, local anti-drug-related loitering laws proscribe a narrow band of activity common to street drug sales but uncommon to legitimate activity: loitering in a drug market area, waving to passing cars, engaging in multiple brief meetings with passing motorists and cars, and covertly exchanging small packages for money. When these activities are seen together, police can enforce local laws that make it a crime to loiter with the intent to sell drugs.

Finally, it may be necessary to remove existing drug market “enablers.” These enablers may range from public telephones used by dealers to conduct business, to bars, dance clubs, and convenience and liquor stores that serve as restocking and meeting places for drug market activity. Pay telephones can be removed or altered so that they no longer receive incoming calls or make beeper calls. Bars and stores can be forced to cooperate either through pickets and rallies or through liquor and business license revocation.

Buyers and Sellers Must Face Penalties

The overt message of open-air drug markets is that both dealers and customers can conduct business with virtual impunity. As a result, drug dealers have little trouble recruiting youths to sell drugs or buyers to buy them.

One way to remove that sense of impunity is to increase the vis-

ible police presence in the neighborhood, particularly around the drug market. When uniformed officers patrol drug markets on foot, customers and dealers are reluctant to do business. When the dealers move, police should move with them, shadowing their activities and hampering their trade.

The efficiency of police patrols can also be increased. In Tampa, local anti-drug-market officers make sure that local citizens know their telephone beeper numbers. A citizen who witnesses street drug sales can page an officer and get an immediate response by phone. The result has been improved citizen-police cooperation and a dramatic citywide decline in street drug activity.

Drug buyers and sellers must face penalties. Because 40 states are now under court order to reduce prison overcrowding, penalties must be found that do not involve incarceration. One particularly effective penalty is seizing cars used by drive-through drug customers. Putting seized cars on display at local malls, schools, and recreation centers, and posting banners across selected streets ("Car Seizure Program in Progress: Drive In for Drugs and Walk Out") can reduce drive-through drug sales to a standstill.

Successful community-based anti-drug-market efforts use a variety of techniques, laws, and methods, but all work to break the back of drug market *mechanisms* rather than merely to maximize dealer arrests. By focusing on that objective, while eschewing the larger issues of reducing generalized drug use and solving deep-seated social problems, most individual neighborhoods manage quickly to achieve measurable success.

With that success, a sense of hope and community spirit generally returns. And that spirit can then be activated to address other pressing problems—from parking and playground problems to truancy and neighborhood gangs.

Getting Past the Round-Robin of Blame

Why aren't more cities adopting the community-based law enforcement techniques that can put street drug markets out of business? One reason is that many communities simply do not know any better. Successful anti-drug-market efforts are still rare, and police are naturally slow to change long-established law enforcement techniques. The other reason is that in most communities no one is held directly accountable for getting rid of street drug markets. Instead of clear policy goals and objectives, drug policy is crafted in a round-robin of blame: citizens blame police, who blame politicians, who blame the city administration, which blames "social forces" ranging from the collapse of family structures to the state of the economy.

Successful anti-drug-market efforts begin with specific individuals standing up and accepting responsibility for solving their community problems. In Charleston, it was the police chief; in Tampa, a Baptist minister; in Chicago, the chairman of the local housing authority; in New York City, the leader of a local community association.

Each of these individuals, independent of the others, crafted his own anti-drug-market program whole-cloth. What they had in common was not race, religion, or job description, but a commitment to action and the conviction that their communities were worth fighting for. From Tacoma to Fort Lauderdale, diverse communities have shown that freedom from street drug markets is possible if individuals will take responsibility for finding local solutions. As one member of a Bronx clergy group put it, "Change starts when you stop talking and start walking the streets. It's dangerous if you fight them because they'll threaten you, maybe rob you. But if you don't do anything, they'll take over your street and rob you too. You're a prisoner no matter how you look at it. The only question is, how do you want to serve your time." ■

What Happened in Tampa

As a Tampa high school principal and Baptist minister, Abe Brown was daily witness to the devastation of drug abuse in his community. Angered by the lack of response from police and local officials, Brown collected more than 4,000 signatures from community members demanding action be taken to eradicate the more than 154 open-air drug markets and crack houses operating in Tampa.

In February of 1989 Tampa's new mayor, Sandra Freedman, took up the challenge. With the help of dedicated revenue from a property tax increase, she hired 101 new police officers to patrol Tampa's streets. Forty-one of the new officers were charged with eradicating street drug markets.

The "Quick Uniformed Attack on Drugs" began by dividing the city into four areas, each patrolled by a 10-person team. Along with a canine unit, each team was given a mobile telephone and a beeper number so that local citizens could report drug market activity directly to local "QUAD squad" officers.

Encouraged by the mayor and chief of police, housing and community inspection officials began routinely following QUAD squads when they served warrants. They closed down crack houses and drug holes whenever they found gross building and health code violations. They boarded up abandoned buildings used as crack shacks and razed 50 abandoned properties. Clean-up drives were organized in drug-plagued neighborhoods, and city personnel and equipment were detailed to help. Using state law, Tampa created a drug nuisance abatement board to close and padlock businesses that served as drug market enablers, and passed a local ordinance against drug-related loitering.

In just two years the number of street drug markets operating in Tampa fell from 154 to 4.

THE CAPITAL GAINS TAX CUT

ECONOMIC PANACEA OR JUST PLAIN SNAKEOIL?



SHOULD TAX RATES on income from realized capital gains be set below rates on other income? In a way, the question is academic. They already are, in practice. Although the maximum statutory tax rate on capital gains is 30 percent, more than half of all capital gains are never taxed. Either they are held until the owner dies, after which they are exempt from tax to subsequent owners. Or they accrue to tax-exempt U.S. entities, such as pension funds, or to foreign owners not subject to U.S. tax. In addition, most capital gains are realized several years after they actually accrue, a delay that automatically and significantly reduces effective tax rates. And the longer the delay, the greater the reduction. In actual practice, the tax rate on capital gains is less than 10 percent.

Advocates of reduced statutory rates, however, clearly want more. To make their case, they offer four lines of argument. First, reducing the tax rate on realized capital gains will promote growth. Second, it will mitigate flaws in the tax system. Third, it will increase tax equity. Finally, it either is, or comes very close to being, a perfectly efficient tax cut: it generates benefits but no costs.

None of these arguments, alas, is valid. Each is either demonstrably false or ignores alternative—and better—policies.

Promoting Growth

To understand why a capital gains tax cut will not promote growth, it is important to keep in mind a key economic identity. Domestic investment is exactly equal to private saving less the government budget deficit less U.S. net investment abroad as measured by exports minus imports. That assertion is not a matter of opinion or economic analysis. It is an identity that must exist, given the way we count investment, saving, government spending and revenues, and international transactions. The idea is clear enough. Resources for investment can come from the domestic saving left over after paying for the government deficit and from whatever we invest abroad. (In recent years the United States has been borrowing from foreigners, not investing abroad.) There is nowhere else to get the resources.

Private Saving

If the reduced rate on capital gains is to boost private saving, it must do so by increasing the after-tax rate of return to saving. Economists have debated whether private saving really does increase when the rate of return rises. In theory, the effect could go either way. A higher rate of return lessens the *need* to save (someone saving, say, to make a down payment on a house five years hence can put aside a little less each year the higher the rate of return). But it also makes saving more *attractive* (bringing within reach, for example, the goal of saving enough to make a down payment on a larger house).

Most economists think that private saving will rise if the rate of return increases, but they are unsure how much. One widely used estimate is that of current Council of Economic Advisers chairman, Michael Boskin, who suggests that a 10 percent increase in the rate of return would boost saving about 4 percent.

Say that the average annual rate of return to capital is 10 percent, that one-third of this return accrues in the form of capital gains, and that the effective rate of tax on these capital gains is the maximum statutory rate of 30 percent. If so, reducing the capital gains tax rate by one-half (about what President Bush is seeking for assets held three years or more) would increase the rate of return by 7 percent, which would boost private saving by just under 3 percent. If these crude assumptions are valid, then, given the current U.S. net private saving rate of under 5 percent of gross domestic product, the capital gains tax cut would boost saving by 0.15 percent of GDP. Given standard economic models, such an increase in saving would raise growth of national income no more than 0.02 percent of GDP.

In fact, this estimate grossly exaggerates the effect of a capital gains tax cut on private saving, since, as noted, the effective tax rate on capital gains is actually less than 30 percent. Thus, the effect on growth through private saving, at best, is vanishingly small—assuming that saving really does increase when the rate of return rises.

Investment Demand

Nothing in any proposal, Republican or Democratic, to lower capital gains tax rates would require that investments be made in the United States to qualify for reduced rates. Nothing in any proposal, therefore, would tend to shift one cent of investment by U.S. taxpayers to the United States from abroad.

For that reason—recall the domestic investment identity—the reduced capital gains tax rate can increase investment in the United States only by increasing U.S. saving or by increasing borrowing from abroad (thus enlarging the trade deficit). We have already seen that U.S. saving cannot be expected to show a detectable increase. The only remaining way to boost U.S.-based investment significantly would be to increase foreign investment here.

If anything, however, a capital gains tax cut would lower, not raise, such investment. Any increase in U.S. saving and U.S.-based investment by U.S. savers would tend to lower the after-tax rate of return on investment in the United States. The decrease in the rate of return would be negligible if U.S. saving did not increase much, and the drop in foreign investment in the United States would also be small. But one thing is clear: a drop in investment in the United States by foreigners, however small, is not an increase. And such a drop would partially offset any increase in U.S. saving and further reduce any positive effect on U.S. economic growth.

Shifting the Composition of Investment

Even if a capital gains tax cut would not increase the *quantity* of investment, it might improve the *quality* of investment. But it could do so only if markets now rank investments incorrectly, favoring relatively low-productivity projects over high-productivity ones.

Is it possible that investors fail to appreciate the virtues of really terrific projects—and need reduced capital gains tax rates to help them see the light? Or that capital markets systematically deny resources to highly promising projects?

No such case can be sustained for investments undertaken by established corporations. They have ready access, through retained earnings, bank loans, sale of debt, or new stock issues, to the capital they need for new investments. They can choose the projects managers think will produce the highest expected returns, with proper allowance for risk.

Nor can such a case be made for investments, such as real estate, that can be financed largely with borrowed funds. Because the inflation component of interest is immediately deductible, while the inflation component of asset appreciation is untaxed until the asset is sold (and not taxed at all if the gains are not sold during the life of the owner), such investments are already powerfully favored by the tax system.

Is the case, perhaps, stronger for reduced capital gains taxes on investments in new companies, which do not have ready access to capital markets, but which create new products and fuel employment growth? Not really. To begin with, the contribution new companies make to output or employment growth tells precisely nothing about whether too much or too little is invested in them. It is not even relevant to the debate. Whether investments in new companies are too large or too small depends on whether their expected rate of return is greater or less *on the margin* than that on other investments.

Second, almost 90 percent of venture capital invested in new companies comes from sources—such as pension funds and foreign investors—that are tax exempt and thus unaffected by a tax cut. The argument that reduced capital gains tax rates would attract new funds to venture capital investments hinges on the likelihood that reducing a tax whose effective rate is already well below 10 percent to perhaps 5 percent would cause savers to disgorge a great deal of capital.

That argument is utterly implausible. If the net return on an investment after tax under current law is, say, 100, the tax cut would boost the net return at most to about 105, an increase of roughly 5 percent. If the supply of capital from taxable entities were highly responsive, it might grow 20 percent, raising the total supply of venture capital about 2 percent. Since *total* venture capital is less than 1 percent of total U.S. capital, and *taxable* venture capital is only 12 percent of total venture capital, the increment to investment from cutting capital gains taxes is likely to be about 0.02 percent.

These calculations are crude, but they are in the ballpark. The growth effects of any cut in capital gains taxes cannot be more than trivial.

Fixing Problems in the Tax System

Yet another line of argument for reducing capital gains tax rates is that doing so would mitigate two flaws in the current tax system.

First, inflation causes distortions in measuring capital income. (Because of inflation, nominal capital gains exceed real capital gains and nominal capital losses fall short of real capital losses.) Would cutting the tax rate on capital gains help minimize the distortion? Sometimes yes, sometimes no. For example, a reduced rate would actually *aggravate* the distortions on capital losses,

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adding the insult of a reduced rate for calculating tax offsets to the injury of understating the loss. To measure income correctly, it is necessary to index the calculation of capital gains—and of other forms of capital income, notably interest and depreciation.

Second, because corporate income is subject to tax at both the corporate and personal levels, the tax system may contain biases against investments in corporations. Projects that depend on the capacity of corporations to amass capital may have difficulty competing with projects that could be financed equally well by partnerships or single proprietorships.

Whether the double taxation of corporate income produces such distortions is a matter of dispute. In any event, cutting the capital gains tax does not solve the problem presented by double taxation and may aggravate it. The difficulty is that a large share of capital gains arises from real estate investments, which typically rely heavily on borrowing. Current rules impose what amounts to negative rates of tax on interest income to the extent that interest is paid by taxable entities and is received by exempt entities, such as pension funds, insurance companies, or foreigners. Extending reduced rates to capital gains, the major additional avenue through which capital income on real estate investment flows, would exacerbate an existing distortion.

More fundamentally, if double taxation is a problem (and I think it is), the responsible approach is to try to fix it, not paper it over.

Equity

Would a capital gains tax cut increase tax fairness? No objective argument can be made to show that one distribution of incomes among income classes is more or less fair than another. Equity is clearly in the eye of the beholder.

But even subjective judgments should rest on fact. It is a fact that inequality among income classes has increased greatly since the late 1970s after nearly three decades of approximately unchanged income shares. From 1977 to 1988 after-tax real incomes of the bottom 80 percent of the U.S. population rose a total of 0.1 percent, while incomes of the top 1 percent rose 96 percent. Meanwhile, the total federal tax rate on the bottom 80 percent of the population was virtually unchanged, while that on the top 1 percent fell by one-quarter, from 35.5 percent to 26.9 percent.

The capital gains tax cut initially proposed by President Bush in the State of the Union message would give the top 1 percent of taxpayers more than 50 percent of the benefits, an annual average of \$3,730 per tax return. It would give the bottom 80 percent 10 percent of the benefits, an annual average of \$8 per return.

To find this kind of a tax policy fair, one would

have to believe that income equality was excessive during the three decades following World War II, that the sharp increase in inequality of the past 15 years has almost, but not quite, corrected those egalitarian excesses, and that more inequality is necessary for social justice. If you believe that, the capital gains tax cut is just what you want.

A Perfectly Efficient Tax Cut?

Sometimes cutting a tax rate can actually generate enough additional revenue to offset the direct loss from the rate cut. Some supporters of reduced capital gains taxes make that claim for their proposal. Those who sell assets, it is argued, will enjoy a tax break. But lower rates will cause people to sell assets they otherwise would have retained. The tax revenue from the added sales will offset the revenue lost by lower rates.

Everyone agrees that cutting capital gains taxes will induce some increase in asset sales. The question is: how much and when? The mathematics is simple. If the proportionate rise in sales is less than the proportionate fall in tax rates, revenues will fall. If the tax rate is cut by half, sales will have to double to maintain revenue.

President Bush proposes to cut rates by 45 percent in 1992 for capital gains on assets held more than one year. In 1993 the rate cut would apply only to gains on assets held more than two years; in 1994 and later years, to gains on assets held more than three years. The rate reduction would be smaller in 1992 and all later years for assets held more than one year, but less than the required period. Current rates would apply to gains on sales of assets held less than one year.

The structure of the cut, it is important to note, discourages the quick sale of assets. But sales of assets can increase only if taxpayers sell their assets more quickly than they do under current law or if they sell assets that they would otherwise have held until death. The president's proposal could easily retard the sale of assets that would be held less than three years under current rules.

Both the congressional Joint Committee on Taxation and the administration assume that realizations will rise. That they will rise the first year or two after enactment seems beyond dispute. Estimating the longer-run effect is more dicey, because no graduated tax rate has existed in modern times.

To offset a rate cut of 45 percent, sales would have to rise 82 percent. According to calculations by Alan Auerbach, such an increase would require (with the proportion of gains realized each year held constant) that the fraction of gains held until death, currently about half, would have to fall to 14 percent. Nothing in the record of capital gains taxation suggests that such a drop is remotely plausible. Accordingly, one can be

quite certain that the president's capital gains proposal will reduce revenues.

In fact, the Joint Committee on Taxation estimates that the combination of the tax rate cut and induced sales will cut revenues \$27 billion over five years if the president's proposal is adopted.

If revenues fall from this source and no other tax is increased, the federal budget deficit will rise and national saving will fall correspondingly. The reduction in national saving would cut investment (unless the flow of borrowing from foreigners increases—again, recall the domestic investment identity), depress growth of national product, and reduce revenues further. If foreign borrowing were to increase enough to sustain investment, national product would not fall immediately, but the United States would acquire additional obligations to make future payments to foreign lenders.

Either way, the capital gains tax rate cut means increasing other taxes or suffering reduced future economic growth, or both.

A Presidential Shell Game

Six years ago Congress boldly reformed the personal income tax. The strategy, embraced by the Reagan administration and by Congress, was to broaden the tax base and lower rates. The two elements of the plan were balanced, so that the share of personal taxes paid by each income bracket remained about the same.

For top-bracket taxpayers, the drop in rates was remarkable—from 50 percent to 28 percent. One of the most important provisions that made it possible to cut top rates without lowering revenues appreciably was the repeal of the provision excluding 60 percent of long-term capital gains from taxation.

Now, barely six years later, President Bush wishes to scrap the capital gains part of the bargain but keep the lowered rates, thereby lavishing lower taxes on income groups that have benefited mightily from rising incomes and lower tax rates, while providing almost nothing to the majority of the population that has suffered from economic stagnation.

With this year's deficit exceeding \$300 billion, any tax cut at all should be viewed with extraordinary skepticism. A tax cut *might* be defensible if it promoted growth. But at best the capital gains tax cut could increase growth only trivially. The danger is that it could depress growth by cutting revenues and diverting even more of the meager U.S. national saving to cover the increased federal budget deficit.

The decade of the 1990s is young, and we cannot know what unpleasant surprises await us. But President Bush's proposal to cut capital gains tax rates merits early nomination as the worst economic idea of the decade. ■

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REGULATING CC

CREATING MONOPOLY WHILE

The electronics revolution has radically changed the life of American consumers. Compact disc players, Walkmen, remote-control television receivers, portable cellular phones, VCRs, sophisticated home-appliance controls, and trouble-free automotive ignition systems are just a few of the devices that households with even modest incomes can now afford. And there is no end in sight.

New applications of electronics now promise consumers a dazzling panoply of convenient new, low-cost communications services. Most, such as pay-television movies on demand, wide-screen high-definition television, electronic yellow pages, home banking services, or inexpensive mobile personal communications service, could be offered by any number of firms. Telephone companies, cable systems, home satellite networks, cellular systems, radio and television broadcasters, retail chains, financial service companies, or even local newspapers are poised to compete against one another for these markets—if government will let them.

Given this array of potential competitors, one might think that competition in the private marketplace would be the best way to separate the winning

Robert W.
Crandall

ideas from the losers. Unfortunately, anyone who has been watching the furious battles in Washington among the various media giants knows that the spoils from these races may not necessarily go to the swift, but rather to those with political clout. The communications giants are eagerly battling for government's permission to compete in new markets while at the same time trying to persuade Congress and executive branch agencies of the dangers of allowing others to play in their existing markets.

There is a long history of government intervention in the communications sector to establish and protect monopolies. Although the past two decades have witnessed a general shift away from economic regulation in such industries as airlines, trucking, natural gas, and railroads, official Washington is very reluctant to relinquish its control over the communications media. Often it justifies its actions by arguing that there are both dangers to allowing government-protected monopolies to extend into new markets and costs to allowing new competitors to take markets from protected monopolists. In this setting, defenders of entrenched market positions cannot be blamed for continuing their traditional battle for protection from new competition.

ILLUSTRATION
BY LEW AZZINARO



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‘PROTECTING’ US FROM IT



The U.S. government has controlled the evolution of private operations in these markets, preventing or slowing new competition at every turn.

themselves to offer telephone service in their franchise areas. This service could be provided through an extension of their current networks into the switching of voice and data. Few people expect cable companies to duplicate fully the local telephone networks, but they could establish cellular or radio-based “personal communications networks” by building small antennas along their trunk lines and adding switching capacity to their plant.

As cable grew in the 1980s, it was faced with a paucity of programming to fill its burgeoning channels. As a result, many cable companies formed consortia to finance new program services, such as The Learning Channel, Black Entertainment Television, and Encore. Not surprisingly, the owners of the other program services began to complain to Washington that this amounted to unfair competition. Owners of home satellite dishes did likewise. Thus far, the complainants have been unable to get the Federal Communications Commission or Congress to force cable companies out of the programming business.

Finally, cable is engaged in a major struggle to fend off rate regulation. Rates were deregulated by the 1984 Cable Act. In the meantime, cable systems have vastly increased their channel capacity and program offerings while, not surprisingly, increasing rates. The rate increases have led to congressional attempts over the past three years to reimpose limited rate regulation—attempts spurred on by many of their existing and potential competitors. As this article goes to press, different forms of rate reregulation are before the Senate and the House of Representatives, but there is a strong possibility that President Bush will veto any final legislation.

BROADCASTERS. Television broadcasters, long the beneficiaries of the FCC’s choke hold on cable television development, now want regulators to order cable systems to carry their signals at no cost. As broadcasters lose their market shares to 40, 50, or even 100 channels of cable and (potentially) to new direct-broadcast satellites, they are searching for some way to use regulation to slow their slide. Thus far, they have been notably unsuccessful, perhaps reflecting the correlation of economic power with political power.

Ironically, the broadcasters’ attempts to enter other

media markets are impeded by FCC rules that prevent them from owning programs shown on their networks. These misguided rules were imposed 22 years ago in response to the motion picture companies’ complaints that the networks had too much power in determining the terms under which they licensed new series. Even though these rules could not have the effect the motion picture companies suggested, they remain in place—largely to keep the networks from competing with the large movie companies in the lucrative market for reruns.

PUBLISHERS. Newspapers and book publishers are in a virtual panic about the prospects of having to compete with telephone companies for directory and classified advertising. Many large daily newspapers have failed over the past two or three decades. As a result, most large city newspaper markets are highly concentrated, providing the remaining newspapers with at least the possibility of exploiting market power in local classified advertising. One might think that Congress would welcome new competition in this market, but instead it appears ready to pass a bill that would deny telephone companies the right to compete with newspapers in advertising and information markets as long as the telephone companies are regulated local monopolists.

SATELLITES. The international consortium of telephone companies that controls transoceanic satellite services through Intelsat has waged a long and generally successful battle to prevent competition from new private satellite carriers, such as PanAmSat and Orion. These latter carriers have been unable to enter as full-fledged competitors because they would erode Intelsat’s carefully crafted system of cross subsidies that are distributed through regulated or nationalized telephone companies.

MOTION PICTURE COMPANIES. The large motion picture companies have been successful for more than two decades in persuading the FCC to keep broadcasters from competing with them in the market for television reruns. The movie companies argue that the contrived monopoly power created by the government’s allocation of television channels requires that program “ownership” and broadcasting be kept separate even as the broadcasters’ market power is being eroded by new technologies. The fervor of their

argument seems strangely unaffected by the enormous decline that the networks are now experiencing because of cable television, pay cable, pay-per-view, and satellite systems.

An Explosion of New Technology

How has government become so involved in determining who can compete with whom in delivering valuable information and services to American households? The answer is partly the rapid change in technology wrought by the electronics revolution and partly populist fervor—resulting in government controls of “monopolies” that are themselves the result of prior government controls.

Many of the communications policy contests in Washington have been stimulated by the explosion in new technology over the past two decades. Few sectors of the U.S. economy have been more heavily affected by the electronics revolution than communications. Twenty-five years ago, facsimile machines were an expensive novelty; all forms of telephone service and equipment were available only from a franchised monopolist, either AT&T or an independent telephone company; videotex services such as Prodigy were simply unavailable to consumers; cable television had spread to only 15 million homes; pay cable did not exist because satellite distribution of television signals was not yet available; and mobile telephone service was so expensive that few used it.

Today, businesses can link offices together with private or public networks, use electronic mail for internal communications, access off-site data bases such as Lexis/Nexis through a number of competitive carriers, and market their goods and services with high-tech communications. Households now routinely purchase their own wireless and cellular telephones; access hundreds of videotex services through inexpensive PCs; roam across scores of cable or satellite channels for their favorite news program, motion pictures, or sporting events; or buy their own fax machines to communicate between their homes and offices.

Each of these new services inevitably provides competition for an existing service that is regulated by the FCC, by state regulatory commissions, or even by the federal courts and that may look like a “natural monopoly” to populists at the outset. Politicians and regulators must then decide how to control incumbent carriers in the face of the new, unanticipated competition. Their record is quite consistent: they slow or stop the development of the new technologies to protect the established interests—obviously only to protect the “public interest.”

Government:

Grantor of Monopoly Privileges

It is hardly surprising that government authorities would view communications media as crucial to the functioning of the state, or at least to their administration of it. In most societies, the public sector gravitated easily from delivering the mail to owning and operating first the telegraph, then the telephone company, and finally the broadcasting sector. Control

of the media is of obvious importance to an authoritarian government, but even Western-style democracies followed the pattern of socializing each new communications medium, in large part to protect its previous, inefficient monopoly. As a colleague once told me, some services are simply “too important to be left to the market!”

Government-owned telegraph and telephone systems were (and are, though decreasingly) used by European governments to cross-subsidize woeful postal systems. State-owned broadcasting systems have been seen as important instruments for controlling the cultural development of each nation and for protecting people from their own worst instincts. Ironically, the newest technology developed by the French state-owned telephone company, videotex, is being supported in no small part by the dissemination of prurient messages among consumers.

Fortunately, the United States avoided the worst excesses of state control of communications. The federal government refused offers to buy early telegraph operations, and it never owned telephone or broadcasting systems except for its own internal use. (Even “public” broadcast stations are generally private, non-profit institutions.) Nevertheless, the U.S. government has controlled the evolution of private operations in these markets, preventing or slowing new competition at every turn.

TELEPHONE. As early as World War I, the U.S. telephone industry began to fall under federal government control not because it was a monopoly, but because one company, a predecessor of AT&T, decided to fend off antitrust action by agreeing to submit to government regulation. At that time, telephony was not a monopoly; indeed, AT&T was brought to heel in part because it was too aggressive in dealing with independent rivals who provided telephone service to nearly half the country's subscribers.

In 1921 legislation was passed that exempted telephone mergers from the antitrust laws as long as regulatory authorities approved, allowing AT&T to resume its acquisition of competitors and thereby control access to more than 80 percent of the nation's subscribers. Telephone service became a regulated monopoly, not because of the economics of “natural” monopoly, but because of government intervention and protection.

TELEVISION BROADCASTING. The story in television broadcasting is much the same. In 1970, most large metropolitan areas had no more than three VHF television stations and perhaps one or two noncompetitive UHF broadcasters, not because of a “scarcity” of spectrum, but because the FCC, heavily constrained by Congress, was loathe to allow competition in this market.

As early as 1954, the FCC could have allocated the spectrum to allow at least seven or eight competitive television stations in all major markets, but that would have disrupted the monopoly privileges of the early recipients of renewable “three-year” television licenses that were to become perpetuities worth billions of dollars. As a result, for at least 25 years, American households were denied the kind of choice

they were later to enjoy only when cable television was permitted to grow.

CABLE TELEVISION. In the 1960s, cable television developed as a medium for retransmitting broadcast signals in areas with poor local reception. Had the FCC not intervened in the late 1960s and early 1970s, cable systems would have begun to offer pay cable and numerous imported distant broadcast signals much sooner. Instead, the FCC blocked cable by limiting the number and variety of signals it could offer, purportedly to encourage the development of marginal UHF broadcast stations and to protect local television programming.

Ironically, the FCC claimed to be encouraging nascent UHF broadcast stations by limiting the competition from cable when economic research had shown quite conclusively that the growth of cable would actually *stimulate* the growth of UHF broadcasting by improving the signal quality of these higher-frequency stations for many households. The policy rationale of stimulating local programming was no more than an excuse to protect incumbent broadcasters and was based on no empirical evidence that local programming would decline in a more competitive market.

The development of satellite technology provided the technological breakthrough that allowed cable systems to receive potentially hundreds of channels of programming to compete against broadcasters who were still leapfrogging their signals around the country on leased microwave circuits. The FCC, however, restricted cable's use of this new technology by limiting distant broadcast-signal importation ("Superstations") and virtually prohibiting pay cable offerings of live sports and recent movies.

When the FCC's regulation of pay cable was reversed by the Court of Appeals in 1977, cable began to develop. President Carter's FCC subsequently released cable from the limits on imported broadcast signals, and cable began to grow explosively. Today, nearly 90 percent of all homes are passed by cable, and fully 60 percent subscribe to it. As predicted, UHF stations grew rapidly with cable's help in the 1980s. The average household today receives 31 channels, not the three to five permitted by the FCC in the late 1960s when it first moved to restrict cable's growth, and no one seems to care whether "local" programming has survived. (It has.)

In most communities there is only one cable service. Duplicate or "overbuilt" cable systems have not developed because of municipal franchising restrictions and because of the economics of the medium. It is unlikely that many would want to challenge an incumbent cable operator because a large share of the incumbent's costs are sunk. The incumbent would be free to drop rates dramatically and still cover variable costs, thereby frustrating entry of any but the most heavily capitalized of entrants. The most likely competitor for cable is, as we have seen, the telephone company, but the phone company is banned from competing by the 1984 Cable Deregulation Act.

The 1984 act also bars government regulation of cable rates in markets that the FCC deems to be effectively competitive. For many years, "effective" com-

petition was defined by the FCC as three or more local broadcast stations. That standard has recently been raised to six. But because cable operators raised rates while increasing the number of channels of service after 1984, Congress has been persuaded to consider reregulating cable rates. If this is accomplished, we can presume that there will be pressure to keep these regulated cable companies from investing in telephone services for all the same reasons that telephone companies are currently barred from cable services.

Telephone as the Dreaded New Competitor

If satellite distribution of video signals facilitated the growth of cable, still another new technology, fiber optics, may replace it. Fiber-optic delivery of video signals could now be offered by telephone companies, who themselves face a good deal of competition from new technology.

The FCC, entrusted with regulating interstate telephone service, lost control of the process in the 1960s and 1970s when the courts all but forced them to allow competition in terminal equipment (telephone sets, modems, answering machines) and long-distance services. The new microwave technology permitted smaller-scale entrants to compete with the established monopolist, AT&T, in the denser long-distance markets, and the revolution in electronics technology potentially allowed consumers to connect something other than their local telephone company's ugly, heavy instrument to their telephone lines.

After wrestling with AT&T over the details, the FCC eventually succeeded in opening up the terminal equipment market, but it never had any intention of allowing competition in ordinary long-distance services. It allowed MCI to offer limited, dedicated business services beginning in 1969, but MCI quickly used its new facilities and leased local circuits from AT&T to enter as a full-blown long-distance competitor. It is more than an interesting aside that although MCI's first proposed service was between Chicago and St. Louis, its headquarters were located in Washington, only two blocks from the FCC.

When AT&T tried to use its local operating monopolies to frustrate entry into long-distance and terminal equipment, it was sued by U.S. authorities in 1974 under the Sherman Antitrust Act and eventually broken up in 1984 under a decree that, as mentioned, restricts the divested Bell operating companies largely to providing local telephone service. It was during the late 1960s and 1970s that AT&T earned the reputation as a predatory defender of its government-provided monopoly status. This reputation has now attached itself to AT&T's divested children, the BOCs.

Local telephone service remains somewhat of a monopoly. Reminiscent of its decision to limit television spectrum allocations in the 1950s, in the mid-1970s the FCC limited cellular telephone service to just two carriers, one of which is the local telephone company, and took nearly a decade in licensing this spectrum, thereby limiting its potential threat to traditional telephone companies.

Perhaps the most important reason for the lack of

competition in local telephone markets is the populist tendencies of state regulatory commissions, who insist on keeping rates to residences in smaller communities and rural areas below cost, thereby making competitive entry very unprofitable. Residential rates are cross-subsidized by business rates and other services, such as intrastate long distance. The obvious result is that local telephone companies continue to enjoy a franchise monopoly in providing network access to millions of residential and small business subscribers even though local competition may now be feasible in many of these markets if local service were not subsidized by other services.

The FCC and the court administering the AT&T antitrust decree are loathe to allow local telephone companies to use available technology to enter the brave new worlds of television and information services. After all, it is argued, AT&T was very, very bad, and some of the divested Bell companies have also abused their monopoly positions. Therefore, the Bell companies cannot be allowed to enter the markets that advances in digital communications and fiber-optics technologies have potentially opened to them because they might cross-subsidize from their protected, regulated monopoly base of plain old telephone service.

Part of the regulatory logjam was recently broken when, in 1990, an appellate court forced the court administering the AT&T decree to allow telephone companies to offer information services—electronic yellow pages, financial market data, billboards, dating services. (Predictably the newspaper publishers and book publishers have begun lobbying aggressively for federal legislation that would reverse this decision, and may well succeed.) But the telephone companies are still blocked from using the wonders of modern fiber-optics technology to deliver potentially hundreds of television programs to homes in their local market.

It is a classic catch-22. Telephone companies cannot offer television services because they might cross-subsidize them from their regulated monopoly services. But rate regulation is a major cause of local telephone monopolies. If telephone service were more competitive, rate regulation would be unnecessary, and there would be no reason to limit telephone company entry into any market.

Breaking the Logjam

In the early days of the videocassette recorder, Hollywood studios were fearful that they would lose control of the distribution of their copyrighted motion pictures and television programs. They have since learned that the new distribution channel provided by VCRs has redounded enormously to their benefit. When they realize how much more money they could make if the government would only allow new, competitive distribution technologies to develop, they may apply counterpressure similar to that used by large businesses in developing new long-distance networks.

Over time, regulatory rules that protect incumbent monopolists break down because of the competition that develops from new technologies and new services. Congress and the regulatory agencies can keep their fingers in the dike that protects incumbents only so long. Eventually, the new technology simply pours over the dike. We have competition in telephone equipment, long-distance services, and the distribution of video signals today only because new entrants challenged the old regulatory order and finally won in court. Had it been left to Congress, all telephone service would probably still be monopolized.

Eventually, it becomes politically embarrassing or futile to protect six-day mail delivery times from the competition of overnight express or facsimile machines—or to keep HBO, Showtime, and local premium cable sports channels from developing as competitors to marginal, uninteresting UHF television stations. In a country of aggressive entrepreneurs, creative energies are expended on ways to offer the new technologies despite government-erected barriers to competition. It is a pity that these energies could not be devoted to more immediately productive activities.

Eventually, U.S. households will have hundreds or even thousands of television programs available to them on demand, and terrestrial broadcasting will be found only in the William Paley museum. Local telephone monopolies will fall victim to ubiquitous pocket telephones that connect through the spectrum. Dial-up electronic advertising will make it possible to find a job opening or a used car without ever picking up a newspaper. The losers in this battle will perhaps have the “satisfaction” that they delayed progress for a while—at the public’s expense. ■

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THE GLOBAL TELECOMMUNICATIONS PICTURE



IS AMERICA BEING OUTSTRIPPED?

BY FRANCE?

The Bell System is like a damn big dragon," Frederick Kappel, the legendary former Chairman of American Telephone and Telegraph said in 1962. "You kick it in the tail and two years later it feels it in its head."

Ten years ago, U.S. District Court Judge Harold Greene swung his flashing sword—an antitrust decree—and slew the AT&T monopoly dragon. He carved what was once the world's biggest company into eight smaller pieces. Culminating an eight-year court battle, AT&T was told to shed its local phone operations and become a regulated long-distance carrier and equipment manufacturer. Did Americans gain or lose?

In his recent book, *After the Breakup*, Brookings scholar Robert W. Crandall concludes that "on balance, the efficiency gains from the opening up of the telephone industry have more than offset the possible losses that may be caused by the sacrifice of economies of scale and scope or the absence of fully compatible equipment and services." His data underscore the microeconomic principle that competitive markets waste less output than regulated monopolies. Crandall and other experts also believe that as competition spurs ri-

Shlomo
Maital

valry for market and market share, companies become more innovative in their products and services.

Several recent studies, however, cast doubt on the alleged efficiency gains from increased competition in the United States and Britain. Sumit Majumdar, of the University of Michigan, analyzed 22 Bell operating companies and another 18 private firms in the U.S. telecommunications industry during 1973–87. He found steep efficiency gains in generation of output between 1973 and 1981, prior to deregulation, with the efficiency "score" rising from 56 percent to 91 percent (100 percent represents full efficiency), but no change after 1981, the year of the Greene decree. And in cost reduction, Majumdar found that half the sizable efficiency gains occurred between 1973 and 1981. For British Telecom, University of Chicago economist Arie Avishur estimates that "privatisation has increased efficiency by 2.1 percent."

Narrow cost-benefit calculations, though, are far from decisive and are not the real issue. Above them looms a key fact: before Judge Greene's decree, the United States led the world in telecommunications. Since then, other countries—notably, France—have closed the gap. America's claim to have the world's best

ILLUSTRATION
BY LEW AZZINARO

phone system is now being challenged. And in exports, the United States now has only about 8 percent of the world market in line equipment, down from 10 percent in 1978. (One reason, of course, is the tilted playing field. While the U.S. telecom market is open to competitors, markets in Europe and Japan are essentially closed to American firms.) This erosion of U.S. competitiveness comes at a time when telecommunications have become the cutting edge of competitive advantage for key industries like banking, insurance, and airlines.

France's Videotex Gamble

During a recent visit to southern France, I needed a Paris phone number. Call information? Scramble to find a bulky Paris phone book? No need. I simply went to a ubiquitous computer terminal called Minitel, punched in a name, and within seconds the phone number appeared on the screen. Once frustrating and laughable, the French phone system may now be the world's best—the direct result of smart policy by that bane of competitive markets, a huge government-run monopoly.

The Minitel terminal that served me up a phone number is part of a successful French videotex system known as Teletel. Videotex is a computer-based system that transmits text and graphics to a terminal screen hooked up to a phone line. Pioneered by government-owned France Telecom at great cost during the past dozen years, Teletel is according to some observers at last turning a profit. Six million Minitel terminals, one for every ten French citizens, provide a dazzling array of services.

Though the United States has the technological capability, it has nothing truly comparable on the market. Limited U.S. services similar to Teletel—for instance the IBM-Sears joint venture known as Prodigy—have had only modest success. Most of the world's videotex activity now takes place in Europe, which has 6 million active users, 5 million of whom are in France. The United States has only about a million users. While the United States does have thousands of private computer networks, linked by phone lines, it trails in nationwide network services (like a nationwide electronic phone directory).

Why does France, not the United States, lead in videotex? And so what?

Tawfik Jelassi, an expert on information technology at the French business school INSEAD, probed the matter together with associates Irit Rapaport and Giridhar Murthy. In 1978, notes Jelassi, a report to the French government by Simon Nora and Alain Minc warned that U.S. domination of telecommunications and computers was a threat to France's independence. Reacting fast, the French government, through France Telecom, initiated a costly videotex experiment late that same year to get back onto the global telecom playing field. At the time Judge Greene was breaking up AT&T, France Telecom was investing heavily in Teletel. The investment was a huge gamble.

The challenge for Teletel, notes Jelassi, was "how to launch a mass-market product for which market demand did not yet exist." Demand for the product is created only by saturating the country with videotex

terminals. (If I had had to hunt five minutes for a Minitel terminal, the service would have been nearly worthless.)

But who would invest massively in such terminals without first being assured of the demand for their services? The answer: a government with deep pockets, clear purpose, and a national technology strategy. It is doubtful that a private telecommunications firm in a fragmented industry would have accepted the same risk.

France Telecom set up half a million Minitel units all over France free of charge. (Today, improved second-generation Minitel terminals are rented out for a monthly fee, generally quite low.) Users paid only according to calls they made, with measured-service call traffic France Telecom's only revenue source. And the cost was cheap. Ordering a bottle of wine through a videotex mail order catalog, for instance, cost only the price of a local phone call (about a dime for six minutes).

The Payoff

The gamble worked. Today some 15,000 different services are offered through Minitel terminals, a powerful and classic example of "mass customization" or "economies of scope"—providing a wide and growing range of products, at decreasing cost for each one, based on a single technologically advanced infrastructure. Teletel now offers information services, professional databases, banking services, electronic mail, order processing, cash management, portfolio management, and accounting. And the list is growing, limited only by the imagination of small and large businesses and their customers.

Not all customers have particularly original imaginations. The so-called "pink Minitel"—dating, prostitution, and erotic conversations—generates 3 million call hours a month and \$200 billion in annual sales revenue, a sizable part of total Teletel earnings. Recently the French government slapped a 50 percent "sin tax" on sales revenue from the sex-by-phone network. So far, demand seems predictably price-inelastic.

Jelassi and his colleagues trace Minitel's unique success to three factors: cost structure, technology—and monopoly. France Telecom spent heavily on infrastructure but let businesses bear the cost of developing specific services based on it. The "footloose" nature of Teletel (it is only as far as the nearest phone line) created a broad market over which the huge initial fixed costs could be spread—a major ingredient of its success.

The key technology is a large sophisticated switching system known as Transpac, which enables data bits to be grouped and then transferred as a "bundle" through the system. This "packet switch" cut the cost of sending Teletel messages to a tenth of its former level and made it independent of the geographical distance of the user from the "server."

U.S. firms have similar technologies and cost structures. But after Judge Greene's decree they do not have the necessary nationwide span or the legal right to join together to create it. The terms of Judge Greene's decree explicitly forbid the seven divested Baby Bell operating companies from offering infor-

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mation services like Minitel. (Nynex, U.S. West, and Bell South do offer a computer telephone directory service, but only for white pages and covering only the regional calling area.) Last July Judge Greene “reluctantly opened the gates for the regional Bell telephone companies to enter the information services market,” the *Wall Street Journal* reported, but delayed his order, pending further review in the courts. The matter will doubtless take years to crawl its way to the Supreme Court.

Winners and Losers

A favorite slogan chanted by free market exponents is that “governments can’t pick winners.” In their 1978 warning to the French president about U.S. dominance in telecommunications, Nora and Minc coined a new term, *télématique*—the merger of telecommunications and computers in long-distance distributed computing networks. It would, they predicted, revolutionize society, and government should spend heavily on it. Their report, as we have seen, spurred massive investment by France Telecom.

Recently IBM belatedly adopted a new long-term competitive strategy based on “telematics.” Nora and Minc picked a winner 13 years ago. IBM didn’t. Nora and Minc’s “prophet motive” proved more powerful than IBM’s “profit motive.”

As MIT’s Rudiger Dornbusch told the recent American Economic Association annual meeting, “We should not be too hung up [about government picking a few losers] if they also succeed in picking a few winners. . . . An industrial policy is necessary.” One reason governments *can* pick winners is that they can “fix” the race by appropriate spending, legislation, and cajoling.

In the case of Teletel, France Telecom didn’t really try to pick a winner. It simply provided the tools needed to *create* winners dreamed up by enterprising private businesses. That is a role that governments can and should play. It is the real meaning of the term “industrial policy.”

To make videotex work, you need to coordinate its components: terminals, networks, and related services. That task does not require a big state monopoly. It can be done by a private corporation, like the old dragon, AT&T. But whatever type of market structure is put in place, *someone* has to be the central coordinator. The decentralized videotex attempts of Germany and Britain have been far less successful than those of France, because the coordination is missing.

Huge state-run elephants like France Telecom can not only pick winners and then spend and invest to create them. They also know how to dance—sometimes fast rumbas with private-industry partners.

In September 1987 François Schoeller, the head of France Telecom University, talked to Claude Porcherot, senior executive at Banque Nationale de Paris. Both were troubled by the shortage of experienced French managers—there were precisely 10 in all of France—able to design information networks and then put them to work as part of a long-range business strategy. World-class telecommunications

would be of little use, they reasoned, if French managers were inept at using them.

Schoeller and Porcherot set up a working group, with members from government, industry, and academia, to tackle the problem. The result: a new business school, backed by France Telecom and known as Theseus, that focused solely on communications networks. Just two years after Schoeller’s and Porcherot’s conversation, Theseus opened its doors to its first M.B.A. class of 19 students. No similar American facility exists.

Deregulation and Free Markets

Clearly the breakup of AT&T cannot be seen as a fair test of deregulation and free markets. Baby Bell executives are amused to hear that their industry is “deregulated.” “Reregulated” is a better term. They still face a tangle of federal and state regulators, along with the U.S. district court that administers the 1982 antitrust decree. Each of the 50 states has its own regulatory board. State regulators are, I am told, far less informed, able, and enlightened than federal ones, and respond far more to political pressure.

But there is a broader issue here. Are full deregulation and truly free markets ever, in fact, feasible in a political democracy? The *New York Times* once commented, in arguing against AT&T’s domination of national telecommunications, that you should not let the plumbers decide the temperature, depth, and timing of a bath. But deregulation does not pull the plug on the plumbers. Milton Friedman has argued that *only* economic democracy—free markets—is compatible with political democracy. But under democracy, large monied interests can use their political clout to influence legislation. Plumbers with bags of money roaming the legislature can cause the rest of society to take an unwanted bath.

Changing times and circumstances now cast doubt, I believe, on how wisely Judge Greene restructured and “reregulated” American telecommunications. Global markets now mean that even if a single firm dominates the *domestic* market, it is kept honest by foreign competitors, eager and ready to contest its supremacy if they are allowed to do so. France Telecom, for example, exports videotex services to Italy and Switzerland. Half a million Italian subscribers access the French system through a Minitelnet Gateway. The system handles billing and revenue-sharing, so that users are billed directly by the Italian telecom firm. This belies the hoary notion that America can cut its trade deficit by exporting only manufactured goods, not services.

Competition among Global Giants

Ironically, by ostensibly stimulating competition at home, the breakup of AT&T may have hobbled U.S. firms’ ability to compete abroad. And ultimately, as with U.S. manufacturing, losing competitiveness abroad will create *less*, not more, long-term efficiency and employment at home.

In an open economy, nearly all markets are contestable, even those with a single domestic supplier. America is doubtless an open economy.

Huge state-run elephants like France Telecom can not only pick winners and then spend and invest to create them. They also know how to dance—sometimes fast rumbas with private-industry partners.

In the age of economies of scope and mass customization, companies often best compete by cooperating, joining forces to develop and acquire expensive technologies that none could afford alone. Marketplace competition may in fact *require* “collusion” at the research and development stage. Today companies often compete best in the market by cooperating in the R&D lab. Antiquated antitrust laws and the partial “half-coffee half-tea” deregulation of markets are often hostile to such joint ventures.

A fragmented American telecommunications industry is increasingly coming up short against government-backed Telecom firms in Europe, as Minitel shows. A recent study by G.D. Nguyen contrasted telecommunications R&D policies in the United States, Europe, and Japan. America is “demand-pulled,” he claims. Big telecom customers and cable television guide R&D spending of telecom firms. In contrast, Japan is “supply-pushed,” with heavy government direction guiding what is seen as the interests of the nation and its industry. Europe, he claims, is “research oriented,” looking beyond what may be at present an ill-defined market. As Jelassi puts it, the French and Europeans ask not “what is profitable?” but “what do we need to develop *in order to have a market?*” Huge Europe-wide R&D projects like COST, RACE, and EUREKA create consortiums that supply the billions needed for such research.

France Telecom is not resting on its laurels. Its next target is integrated services digital network, a new technology that will transmit text, voice, and image through digital signals carried by ordinary phone lines. Again, while American, British, and Japanese firms have talked ISDN for a decade and run pilot projects, France Telecom is investing—this year, Jelassi estimates, about \$150 billion.

Commercial ISDN already exists nationwide in France. Because, like the old videotex, ISDN is a technology in search of a market, France Telecom formed partnerships with some 50 small businesses to develop products. Among them: transmission of X-ray images

or pages from repair books, pictures of holiday resorts for travelers, and facsimile services eight times faster than conventional ones. Some 30,000 ISDN access lines have been installed; each costs about \$50 a month, compared with \$13 a month for an ordinary phone line. Service between France and Germany and the UK has just begun. Broadband, second-generation ISDN requires replacement of copper wires with fiber-optic cables, a huge investment, but plans for it are already being laid. It will carry massive amounts of data at great speed and its screen pictures will be remarkably sharp. With it, vacationers shopping for a resort, for instance, will “tour” their destination on the screen and then decide whether to buy. Already a French music retail chain uses an ISDN audiocatalog to let customers’ ears “do the walking,” enter a store, and listen to selections before buying.

America is still in the thick of the ISDN race. Will outdated notions about monopoly, competition, and industrial strategy, and ill-conceived deregulation policies continue to tie its hands in the global telecommunications race? Will France capture this technology, as Japan seized earlier ones?

Ten years after the AT&T dragon was hewed into pieces, the time has come to rethink and redefine old notions of how markets work and what truly strengthens competition and efficiency. According to MIT’s Lester Thurow, future global economic competition will be far fiercer than in the past. The reason is clear.

Once countries sought niches—products and markets that other countries avoided. Now every industrial country wants to compete in every important industrial market, and each country has the same “hit parade”—microelectronics, biotechnology, new materials, telecommunications, civilian aviation, robotics and machine tools, computers and software. The result is global head-to-head competition in every major market, including telecommunications.

To face innovative European and Japanese dragons, America needs a few of its own. ■

INVESTIGATING

SCIENTIFIC

MISCONDUCT



The Laboratory Is Not a Courtroom

Last December Dr. David Baltimore, a Nobel prize winner, was forced to resign from the presidency of Rockefeller University, only a year after his appointment in 1990. He had lost the confidence of his faculty as a result of controversy resulting from a 1986 paper on genetics and immunology published in the scientific journal *Cell*. The case actually involved one of Baltimore's research collaborators, who was accused of falsifying experimental dates, and Baltimore himself was cleared by the National Institutes of Health. But a prolonged congressional investigation of the case and the aura of bad science that hung over this federally funded research project brought Baltimore's brief tenure at Rockefeller to a bitter end.

The Baltimore case was but one of several highly publicized cases of scientific misconduct during the past decade. Dr. William Summerlin of Sloan-Kettering was forced to resign after having been caught, red-handed, improving evidence of the heredity factor in cancerous tumors by spotting laboratory mice with black ink. In one of the few criminal cases to date, Dr. Stephen Breuning of Johns Hopkins pleaded guilty in federal court to fabricating data on the effects of psychoactive drugs on children. And recently Dr. Robert Gallo of NIH, the discoverer of the AIDS virus, has been accused by a French laboratory of misappropriating its cultures.

Error or Fraud?

Starting with the 1981 testimony of Dr. Philip Handler, President of the National Academy of Sciences, the scientific community has insisted that blatant plagiarism and outright falsification of data and research results are comparatively rare, although it concedes that irregularities in research procedure are widespread. Congress and the media take a more severe view of the matter. Massive federal funding of research on AIDS, cancer, drug addiction, and other threats to public health, and the periodic spates of publicity about biomedical research fraud cases, have produced investigations by three House subcommittees and legislation tightening federal grant requirements. All over the United States researchers have been going public with allegations of misconduct on the part of colleagues and supervisors, some with little substance to back them up.

Since 1987 both the Public Health Service, on behalf of the NIH, and the National Science Foundation have promulgated procedures for investigating and punishing misconduct in federally funded research projects. These allocate primary responsibility for dealing with misconduct allegations to the research institutions concerned. Only if they fail to take prompt and effective action, or if there is convincing evidence of a violation of federal criminal statutes, will NSF's Office of Inspector General or NIH's Office of Scientific Integrity take over the investigation.

Anxious to protect the autonomy of the scientific enterprise and to avert government intervention, universities have moved quickly to adopt more stringent investigative and disciplinary procedures. But the way

they are going about it could make the cure worse than the disease.

American colleges and universities have always had internal disciplinary procedures to deal with the most flagrant breaches of ethical standards. The American Association of University Professors and other education associations offer guidelines. But in complying with the new government requirements, research institutions have been unthinkingly recasting their traditionally sensitive and discreet investigative processes by drawing on American criminal justice procedure as a model. In the process, they are allowing some of the most undesirable features of the criminal justice system to be smuggled in under the benign mantle of due process. Inadvertently, they are distorting the delicate task of investigating questionable research practices and may do lasting damage to the quality of U.S. science.

Nothing but the Truth

U.S. criminal justice trial procedure is adversarial. Each side presents only the evidence favorable to its own case and attempts to discredit the other side. The purpose of a criminal trial is not to elicit the truth but to establish whether the accused is guilty of the specific crime with which he is charged. To protect the rights of the accused, a bristling array of constitutional safeguards applies to federal criminal trials. Some but not all of these safeguards are incorporated into federal administrative and personnel procedures. They do not *per se* apply to suits between private parties or to the internal procedures of nongovernmental institutions.

The traditional academic process for dealing with faculty misconduct is quite different. A preliminary inquiry is followed by an investigation by an officially appointed panel. Only if the investigation finds evidence of personal culpability is there a formal disciplinary hearing to establish whether sanctions are warranted. The preliminary inquiry is normally a discreet affair conducted by a supervisor, dean, or department head. Investigations are more structured, set in motion by a formal recommendation and conducted by a committee or panel of academic peers chosen for impartiality and familiarity with the discipline concerned. Anyone accused or suspected of misconduct normally has the right to be informed of charges against him, to meet with the investigating panel, and to attempt to refute the charges. Due process in the sense of the right to confront accusers, cross-examine witnesses, and summon defense witnesses has been confined to the hearing stage after investigative findings and the filing of formal charges.

When research universities use the term "due process," they usually mean accepted standards of fairness, defined by one leading science administrator as "keeping the accused fully advised of the status of the investigation; allowing him to meet with the investigating committee; providing him with the opportunity to comment on the committee's findings; and allowing him an appeal." Few if any private institutions interpret due process to require application to their

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Civil Law Trial Procedure

The civil law trial model followed in most of the non-English-speaking Western world is strikingly similar to traditional university misconduct inquiries. A civil (or Roman) law trial does not take the adversarial route to establishing the facts. Rather it is a continuous process of winnowing truth from falsehood by a process of inquiry. An examining magistrate looks at the facts, takes the testimony of informants and witnesses, and weighs the evidence. Only after the magistrate has certified a *prima facie* case of probable guilt will a suspect be put on formal trial before a body of judges or jurors.

Civil law trial procedure does not in principle start out with an “accused.” The initial focus is on whether a crime has taken place and, if so, its circumstances. Only after a suspect emerges from an assessment of the evidence will the focus shift to the person responsible. Evidence of every kind is admissible at all stages of the proceedings, but tested for credibility and weighed by the examining magistrate. Witnesses may be called by the prosecution or defense, but the examining magistrate and later the judges, not the lawyers, do most of the questioning. The function of defense counsel is to advise the client and provide legal arguments on his behalf.

Like M. Jourdain, Molière’s *bourgeois gentilhomme* who was astonished to discover that he had been speaking prose all his life, universities have been following the civil law model without realizing it. Common to both is the emphasis on objective inquiry, with accusation and confrontation deferred until specific charges against an accused emerge from the evidence. Implicit in both is the assumption that one-sided advocacy and selective presentation of evidence are not the best way to sort out a complex tangle of facts.

investigative procedures of all 10 amendments of the Bill of Rights. The U.S. Supreme Court itself has drawn a sharp distinction between the due process safeguards required in an adjudicatory proceeding affecting a person’s civil or property rights and the less stringent safeguards applicable to a federal investigation. State governments in general follow the Supreme Court rule in dealing with their own employees.

Today, however, targets of misconduct allegations are increasingly demanding that the elaborate due process protections heretofore reserved for adjudicatory hearings (after charges have been filed) be provided during the investigation and even the preliminary inquiry. In the Baltimore case, the alleged falsifier demanded the right not only to confront her accuser but to cross-examine witnesses during sessions of the investigating committee. More recently a research scientist has sued the University of Pittsburgh for violating his constitutional right to due process in its ongoing investigation into allegations of fraud in his 1979 and 1980 work on the effect of lead on children’s intelligence. Lawyers for researchers are requesting that rules of evidence and trial procedures customary in the criminal justice process be applied to academic investigations.

Sensitive to every imputation of unfairness, and subjected to worst-case litigation scenarios by their lawyers, universities have started to fold under the pressure. A recent survey of 45 research universities revealed that 12 now permit the “accused” in misconduct cases to question witnesses during the investigative stage.

Blowing the Whistle on Fraud

The undesirability of a confrontation between the “accuser” and the “accused” during the investigation phase of a misconduct proceeding should be obvious. Scientists, administrators, and editors of scientific journals agree that only a minute proportion of scientific fraud and plagiarism cases can be detected by peer review and editorial scrutiny. The surest way of exposing perpetrators of scientific fraud is through whistleblowers and informants, especially fellow workers on the same project. They need to be protected. As a practical matter there may be no way to preserve their anonymity indefinitely, but their identity should be protected at least until the investigation is concluded and charges are filed. If the allegations turn out to be unsubstantiated, or more likely unprovable, official anonymity will help to protect the whistleblower from retaliation and damage suits.

Premature exposure of informants can personalize the investigation and divert attention from the evidence to the personalities involved. The identity and motives of a whistleblower or witness ought to be irrelevant to deciding whether misconduct has taken place and who is responsible. In a field characterized by a large gray area of carelessness, overstatement, corner cutting, and premature publication, it is not always easy to detect deliberate fabrications or falsification. In a research investigation the focus should be on research results, supporting data, the record of experimentation, and the intent of the researcher. If plagiarism is at issue, textual comparison should be the key. In an objective inquiry into scientific evidence, confrontation is disruptive and a red herring. It may satisfy the emotional needs of a person tentatively implicated but only rarely will it shed light.

Allowing the target of an investigation or his lawyer to cross-examine witnesses and informants during the investigative stage would be equally disruptive. Cross-examination in a criminal trial is completely alien to an objective inquiry into the facts. As anyone who has attended a criminal trial knows, the witness who tries to state honestly his observations and conclusions, with all

the necessary qualifications, damages his credibility—which is exactly what cross-examining counsel intends. In theory designed to narrow impressions down to a hard core of “fact,” cross-examination is actually used to discredit the witness by exploiting his uncertainties.

Drawing on the adversarial model will also lead to demands to exclude certain kinds of evidence. Hearsay evidence, for example—what a witness says he heard someone say at the time—is excludable in a criminal trial no matter how relevant. Notebooks belonging to a researcher or notes picked up from a lab bench could be challenged on grounds of privacy or “illegal seizure.” Investigators would face objections from lawyers that a particular item of evidence is irrelevant—with the criteria of relevancy drawn from the common law, not scientific experience. Subjects of investigation will be urged by their lawyers not to cooperate with investigators out of risk of self-incrimination—precisely what happened in the Baltimore case.

A scientific misconduct investigation is not a trial. The adversarial model is not only unsuitable to misconduct proceedings but bad for science. It starts the investigative process off with an accuser and an accused, thereby focusing it on an individual instead of on the research or published article in question. It reduces the testimony of witnesses to black and white and encourages witnesses to become advocates of their positions. It diverts attention from the evidence to the investigative process—that is, to procedural rules and the technicalities of due process. It casts suspicion on error, an inevitable concomitant of experimental science. It divides the research community into factions and gives priority to narrow questions of individual guilt or innocence over the larger question of weeding out bad research practices and improving the quality of American science.

Room for Improvement

This is not to say that traditional academic procedures for investigating scientific misconduct are perfect. They can and should take better account of the continuing concerns of the research community over the harm that misconduct investigations can do to individual careers and professional reputations.

University regulations should emphasize that federal law requires them to investigate every misconduct allegation regardless of substance and that the act of investigation carries no implication of impropriety, let alone guilt. Such assurance will not by itself dissipate the cloud of suspicion and fear hanging over people involved, but it will keep the record clean until there are official findings.

Universities should also make clear that an investigation of a misconduct allegation is directed at the research project or published article in question, not at an individual. If anomalies or irregularities are discovered, the presumption will be that they are the result of error. Only if the investigation reveals willful deception should the focus shift to personal responsibility. Only after such a provisional finding should there be an actual accused and an adjudication leading to sanctions.

Institutions might consider dividing investigations into two phases, the first to determine whether a research project or published article is tainted, the second to determine who is responsible and whether there was intent to deceive. Moreover, if there is an “accuser” it should be the institution, not the principal informant, who is merely a material witness.

Anyone involved in a misconduct proceeding should be able to have a lawyer present at any hearing or interview where he may be questioned, provided the lawyer’s only role is to advise the client. Subjects of investigations and their counsel should also

be allowed to propose lines of questioning for other witnesses, but without the right to be present in person unless the investigative panel so allows. These are substantially the rules that govern the hearings of congressional committees.

All Bark and No Bite

Frightening as the prospect of damage suits and the specter of litigation can be, their main purpose is intimidation. In most cases the threat is groundless. Provided an investigation follows fair and tested procedures, known beforehand to all parties, and there is no hint of partiality or bias on the part of the investigating committee, the chances that the findings will be upset by a court or that a damage suit will succeed are minimal.

Damage suits against a professional journal that does no more than withdraw or secure retraction of a scientific paper tainted by falsified research or plagiarism have almost no chance of success. But as insurance, the journal should accompany its action with an announcement that the withdrawal or retraction is the result of official findings of misconduct reached under authority of cited sections of university and federal regulations. There is no recorded case of a libel or other damage suit succeeding in the face of such an announcement.

Another form of insurance against litigation might be to have all university personnel associated with federally funded research, regardless of rank or seniority, sign an undertaking that they have read and accept both the code of ethical conduct and the disciplinary procedures of their institution and will abide by the results of any enforcement proceedings that comply with them. The undertaking might also acknowledge the signatory’s awareness of Section 1001 of Title 18 of the U.S. Criminal Code, which makes deceit and misrepresentation in obtaining federal grant funds a felony offense.

Finally, the essential role of whistleblowers in protecting scientific integrity must be recognized. Scientists must urge Congress to extend the Whistleblower’s Protection Act of 1989 to government grant recipients as well as federal employees.

Curing the Fraud Virus

None of the above will do much to address the causes of scientific fraud, which lie deep within the culture itself. The stakes in major research projects are high and put a huge premium on achievement. Competition for employment and promotion in the top research institutions is intense. The curious practice of “page charges,” whereby authors are assessed a per-page fee for articles published, allows thousands of marginal scientific journals to exist and provide publication outlets for virtually any scientific paper, regardless of quality or even authenticity.

According to Dr. Arnold Relman, editor of the *New England Journal of Medicine*, although cases of gross and obvious fraud are unusual, “the frenzied atmosphere of ‘publish or perish’ results in a lot of trimming, a lot of modification of data, and a lot of duplication . . . that shouldn’t exist.” Relman also deplores research conducted as a corporate exercise where senior scientists operate as directors and managers at levels removed from the researchers who do the work.

The scientific community is particularly susceptible to the fraud virus. According to a recent American Association for the Advancement of Science survey, one in every four U.S. scientists has at some time suspected fraud in the research of one of his or her peers. But the virus will not be eradicated by inflaming the scientific environment and clogging investigative channels with adversarial procedures imported from criminal justice. That strategy may be good for lawyers, but not for science. ■

The public subsidies underwriting the nation's mass transit bus and rail systems are enormous. In 1989 federal, state, and local governments contributed \$7.1 billion to transit operating costs. Capital subsidies brought the total to more than \$10 billion. For every dollar transit riders paid in fares, taxpayers paid two dollars in subsidy.

Not unexpectedly, during a decade of huge federal deficits, tax revolts in the states, and increased interest in privatization and public efficiency, the transit subsidies have been widely attacked. In 1985 President Reagan advised a group of Miami, Florida, county officials that they could have saved money by buying a limousine for each of Miami's transit users instead of building their new system. Tony Snow, in a 1986 article entitled "The Great Train Robbery" in *Policy Review*, estimated that Miami "could have purchased each passenger a \$45,000 condominium for the cost of building the system—and would have been able to throw in a subcompact car with the first year's operating losses." In the case of the Washington, D.C., Metrorail system, Snow suggested that the city could have bought "a BMW for each of its daily passen-

gers." (No one has addressed the question of whether it would be better to buy a limousine, a subcompact, or a BMW.)

The critical issue is whether there is any justification for the subsidies. The argument that transit systems should not run at a deficit assumes that riders are the sole beneficiaries and should be made to cover full marginal costs through their fares. As noted by Patrick G. Marshall in a 1988 report for Congressional Quarterly, "The key to achieving a more efficient transportation system, say many transportation experts, is to make sure that each mode carries its own weight, with users fully funding the infrastructure, and let the market decide which are the most efficient modes for given purposes."

But consider the implications of closing down the transit systems. Immediately more automobiles will take to the roads. Traffic accidents will increase, congestion will worsen, air quality will deteriorate, and more land will be gobbled up by parking garages. According to the Urban Institute, in 1988 some 14.8 million traffic accidents, involving 47,000 deaths and five million injuries, cost the nation \$334 billion. If public transit systems helped avoid accidents equal to 1 percent of that total, the nation saved about

\$3.3 billion, nearly half the total public operating subsidy in 1989. And in his 1988 report, Marshall, quoting Robert A. Poole, Jr., of the Reason Foundation, noted that the time and gasoline wasted in Los Angeles County traffic jams each year could be valued conservatively at half a billion dollars. Even if public transit carries only a fraction of rush hour commuters—in the Philadelphia metropolitan area, for example, about 20 percent of the total, but about 70 percent of those traveling to jobs downtown—congestion and congestion costs would be substantially greater if transit riders got back into their cars.

It is too often forgotten that transit riders are not the sole beneficiaries of mass transit. Society as a whole benefits as well. The question is how the benefits and the subsidies measure up. With public budgets under increasing scrutiny, urban infrastructure aging, and demands for funding of social programs growing more pressing, the billions of dollars spent to subsidize public transportation will surely be a target for cutbacks. If the social benefits derived from public transportation are demonstrably smaller than the subsidy, it may be time to reallocate resources away from transit subsidies. If the social benefits actually outweigh the subsidies, a case can be made to defend the subsidies. (This is not to argue that the existing level of subsidy is warranted since it is also true that subsidies may promote inefficiency. With improved efficiency, the same level of benefits could be achieved with lower subsidies.)

J a n e t R o t h e n b e r g P a c k

YOU RIDE, I'LL PAY

Social Benefits and Transit Subsidies

The Need for Cost-Benefit Analysis

Although much lip service is paid to the need for cost-benefit analysis of public programs, few such studies exist for mass transit. In their absence, proponents can argue that programs are justified by the many obvious social benefits they generate, and opponents can simply assert that the huge expenditures proposed could not possibly be outweighed by the social benefits.

In what follows I sketch out a simple cost-benefit analysis of a single mass transit system. My aim is limited. I do not address questions about whether the billions spent on mass transit subsidies would be better spent on road repair or highway expansion—which are themselves, of course, highly subsidized by all levels of government. Nor do I consider whether air quality and congestion could be more effectively reduced by other means. Radical policy shifts to limit automobile use—a dollar-a-gallon gas tax, a charge for driving in congested or polluted areas, downtown parking restrictions, parking taxes—have been regularly proposed and rejected for decades. What is certain is that the costs of existing transit systems will annually far exceed their revenues. Each year subsidies will be needed and will be the subject of heated debate. Estimates of social benefits can help resolve arguments about whether and how much subsidy is appropriate—particularly if other major public expenditures are similarly evaluated.

My focus is on the commuter rail operations of one of the nation's largest public transport agencies, SEPTA, the Southeastern Pennsylvania Transportation Authority. The SEPTA system faces problems similar to those facing systems in older urban areas—MBTA in Boston, Metro-north in New York, New Jersey Transit. In 1989 the SEPTA farebox covered only 37 percent of costs—roughly the same portion as other systems nationwide—and operating subsidies were nearly \$100 million a year.

Rail systems in general, and in particular the commuter rail systems serving low-density areas, have the highest—and most heavily attacked—subsidy rates of all mass transit. It is here that the potential for wasteful subsidies is greatest and that the need to value benefits is particularly important.

Measuring Social Benefits

Five benefits are clearly attributable to the commuter rail system. First, when traffic is diverted to commuter rail from automobiles, accidents decrease. (The incidence of transit accidents themselves is far less predictable than highway accidents. Serious accidents, however, are infrequent and idiosyncratic. In 1989, for example, there were no fatal accidents on SEPTA

commuter rail and a total of only 46 collision-related injuries.)

Second, reduced road congestion shortens automobile commuting time, a benefit reflected in the familiar drop-off in house values as commuting distances increase from the city center. Third, downtown noise and pollution decrease. Fourth, congestion on alternate transit facilities decreases. And, finally, the welfare of the commuter rail riders increases.

Many transportation analysts believe that the benefit to commuter rail riders in excess of the fares they pay—known as “consumer surplus”—outweighs the losses of the transit system. In the case of SEPTA, this turns out not to be true. Social benefits would not exceed subsidies were it not for the additional benefits to the general public.

Putting a dollar value on these social benefits requires calculating how much beneficiaries are willing to pay for the indirect benefit received. Table 1 shows, in 1989 dollar terms, the estimated value of the five major social benefits from SEPTA for the years 1981, 1982, and 1989. (The two values given for each benefit each year reflect alternative assumptions

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about underlying magnitudes or alternative estimating procedures.) In 1989 social benefits exceeded the subsidy by \$39–75 million; in 1981, by \$11–31 million; in 1982, by \$20–34 million. Even the more conservative assumptions yield positive gains for society despite the huge subsidy. In the early 1980s, about two-thirds of the benefits not covered by fares accrued to the general public and only one-third was consumer surplus for the rail riders; in 1989 the two were about equally divided.

The increase in the estimated benefits from the early 1980s to 1989 is largely attributable to the substantial gain in the value of access to the commuter rail line as reflected in housing prices (line 5 of the table). The oil price shocks of the 1970s increased rail ridership, as did the growth of the downtown in the 1980s.

Another important influence on the net social benefits was SEPTA's cost-control efforts. During 1981 and 1982 Conrail (reluctantly) operated the Philadelphia commuter rail system. In 1983 SEPTA assumed full responsibility for its commuter rail services. Generous federal subsidy guarantees had given Conrail little incentive to reduce costs. After SEPTA took over, incentives to control costs increased substantially: the federal contribution to subsidies declined from nearly 50 percent to about 10 percent. Between 1981 and 1989 SEPTA's real costs fell by 5 percent. As a result, although real revenues fell, the required subsidy grew only 16 percent, and net benefits from the system increased two- to threefold.

Tough Decisions

In trying to make sense of the highly charged ritual attacks on public subsidies, the analytic challenge is to identify and value the social benefits. The practical issue facing public decisionmakers is that social benefits are difficult to explain and subsidies are unpopular.

Those who run and finance the more than 500 mass transit systems in the United States repeatedly face these issues. Should public transit be expanded or cut back? Are the current subsidies too large or too small? Would the community be better off if more riders were enticed to ride the trains? And the ever-present question: why don't fares cover costs, no matter how many times they are raised?

In the case of Philadelphia, it is clear that commuter rail, operating at its current level, generates benefits substantially greater than its costs. If public officials decided to phase out commuter rail in the Philadelphia region, the community would be far worse off, unless some better means to achieve the social benefits were found.

Capturing the Value of Social Benefits

The problem for public policy is that although social benefits are real, they are not translated into transit revenues. No doubt the social benefits of transit systems are reflected in the willingness of homeowners to pay higher prices for houses near train stations and in the development of property in the vicinity of new transit facilities. But these benefits are realized by landowners and developers, not by the transit authority.

If transit authorities could capture this property value enhancement, the required subsidies would be much lower. It is virtually impossible for older systems to capture the value they generate. Development has already taken place, and the original landowners and developers have already reaped the gains. But new systems can use a variety of measures—joint development ventures between the transit agency and private firms, value-capture taxation on new development, and tax-increment financing, to name just a few.

John Landis, Robert Cervero, and Peter Hall, of the University of California, Berkeley, have identified 114 transit joint development projects in some 25 American cities as of October 1990. The projects have not yet resulted in much income to the transit authorities, "either through capital contributions or through yearly lease payments," say Landis and his colleagues, but experiences vary.

Since 1984 New York's MTA system has financed an estimated 3–5 percent of its capital expenditures through joint development projects. Washington's Metrorail, one of the most innovative and active joint-developers, has financed less than 1 percent of its capital expenditures since 1979 in this way—although the period has seen major capital expansion. Washington's "Metro" receives \$1.6 million a year in lease fees from Bethesda Metro Center, as well as smaller sums from a host of other projects at Metro stations. Nonetheless, "such payments have never amounted to more than 0.7 percent of annual operating expenses," say Landis and his colleagues. They identify only six systems that pursued joint developments yielding such annual payments.

They suggest that transit operators may just be beginning to move "up the learning curve" in these matters. In the past transit authorities have neither pursued value-capturing projects with sufficient entrepreneurial vigor nor extracted sufficient revenues from them. If Landis is right, we will see more such projects, and transit officials will make better deals in the future.

If public authorities could make all beneficiaries pay fully for the benefits they receive from the existence of the transit system, the problem of subsidies would disappear, at least where social benefits exceed costs. If SEPTA could tax the substantial benefits it provides in the form of increased land value that now accrues to the landowners, the subsidy picture would look far different, and the decibel level of public discussion would diminish considerably. With only limited value-capture possible, efforts to contain subsidies will have to continue to concentrate on reducing inefficiency.

Worth Every Penny

If the repeated and rancorous battles over transit subsidies succeed in seriously diminishing transit service, the loss may extend beyond those who rely on commuter rail. In Philadelphia, at least, and perhaps in New York and Boston and other cities as well, the general public gets more than its subsidy's worth from the fact that others ride the commuter trains. ■

Table 1. Estimated Social Benefits of Philadelphia's Commuter Rail System¹

MILLIONS OF 1989 DOLLARS

	1981		1982		1989	
	LOW	HIGH	LOW	HIGH	LOW	HIGH
1. DECREASED ACCIDENTS²						
Fatal	2.4	5.8	2.4	4.5	2.4	5.4
Nonfatal	4.8	11.6	4.8	9.0	4.8	10.8
2. DECREASED CAR AND TRUCK COMMUTING TIME³	29.0	32.5	26.6	26.6	34.0	49.0
3. DECREASED CONGESTION AND POLLUTION⁴	3.4	3.4	2.7	2.7	3.0	6.0
4. WELFARE GAINS FOR TRANSIT RIDERS⁵	25.0	32.0	19.0	27.0	21.0	30.0
5. WELFARE GAINS FOR COMMUTER RAIL RIDERS⁶	30.0	30.0	31.0	31.0	72.5	72.5
TOTAL SOCIAL BENEFIT	95.6	115.3	86.5	100.8	137.7	169.8
SUBSIDY	84.3		66.3		98.9	
NET BENEFITS	11.3	31.0	20.2	34.5	38.8	74.8

1. Behind the calculations are important assumptions about how many commuter rail riders would have driven or been passengers in automobiles; how many would have ridden other forms of public transit and how many existing highway and public transit users would have been affected by increased congestion and delay as a result; and average distances traveled and travel times.

2. Calculated based on road fatalities of 1–1.5 people per 100 million miles traveled; on the Urban Institute's detailed May 1991 study of the costs of fatal highway crashes; and on the ratio of the costs of nonfatal to fatal highway crashes as estimated by the Urban Institute.

3. The decrease in commuting time for all highway commuters on routes parallel to commuter rail lines is assumed to be proportional to the potential increase in traffic and is valued, following Federal Highway Administration estimates, at \$7 an hour. As an alternative I have used annualized values of estimates of the increase in house prices due to reduced highway commuting times in the Philadelphia area (Richard Voith, study for the Federal Reserve Bank of Philadelphia, November 1991). The value of lost time for heavy trucks is based on calculations made in a June 1991 Urban Institute study by William A. Hyman.

4. The social benefits of the additional congestion and air and noise pollution avoided are assumed to be \$1 to \$2 per vehicle each day.

5. The average increase in travel time on the other forms of public transit most likely to have been used by commuter rail riders is assumed to be proportional to the average change in ridership on the relevant routes. The time saved is valued at \$7 an hour (23–35 cents per passenger trip). I assume a willingness to pay 10 cents a day for less crowding.

6. Estimates of the capitalization into house values of accessibility to the regional rail system have been converted to figures reflecting the willingness of households to pay premiums for houses in census tracts with commuter rail stations (Richard Voith, *American Real Estate and Urban Economics Association Journal*, March 1991).

Japan's Falling Stock Market

BY GEORGE L. PERRY



Do stock markets in different countries influence one another? Economists enjoy tackling that problem in a theoretical way, but these days the question is not an academic one for American financial officials and investors. For several years through 1989, Japanese stock prices soared beyond any levels that experience with Western markets would have predicted. They have fallen since then, with only a few sharp upswings along the way. As of mid-May, when this is being written, the broad Nikkei average—akin to our Dow Jones—was at half its peak value, and many individual stocks have fared much worse. Financial firms, such as Nomura securities, and the Japanese telephone company, NTT, have fallen to just 20 percent of their peak prices. It remains to be seen whether the stock price decline contributes to a slump in the real economy of Japan—perhaps by impairing the lending capacity of banks and insurance companies with huge losses in their stock portfolios.

One sign that the worst may be over is that optimistic U.S. investors, using conventional valuation measures, believe Japan's stocks have reached bargain levels. But this judgment is chancy, both because it rests on nearly impenetrable Japanese accounting and institutional practices and because markets often overshoot the levels dictated by economic fundamentals even when these are readily understood. (Wall Street, by the way, has a maxim warning those who think they can find the bottom of a slide like the Tokyo market's: "Don't try to catch a falling knife.")

More pessimistic financial officials and investors worry that the collapse in the Japanese market could spread to the United States. Supporting this fear are studies that have found positive correlations among the

movements of markets in different countries. It's true that if London prices are up in the morning, chances are better than even that New York will be up later in the day. But it is useful to consider two possible causes of these historical correlations and whether either is at work today. First, both markets could react in the same direction because both are hit by similar changes in economic fundamentals that drive stock prices—say, the invasion of Kuwait that threatened world oil supplies and so increased the risk of recession and inflation in industrial nations. Second, conceivably, one market could be correlated with the other not because fundamentals have changed in the same way for each, but because a market's own dynamics, including price movements unconnected to changes in fundamentals, are somehow contagious. Such a link is most likely if the same investors are important in both markets.

Neither of the two possible causes for correlation is at work here. The main changes in Japanese fundamentals over the past few years have been distinctly their own. One big change was in interest rates. The pre-1989 runup in the prices of Japanese stocks (and land) came in part from the extraordinarily low interest rates maintained throughout most of the 1980s by the Bank of Japan. Starting in late 1989 a new central bank chairman let Japanese rates rise until they were more nearly in line with those in other industrial nations—in large part to head off still further runups in asset prices. The new rates were hardly draconian. But they were a big change from the near-zero real rates of the 1980s, and they contributed directly to the steep decline in stock prices by putting a bigger discount on future earnings of firms.

A second change in fundamentals followed the interest rate change. Part of the stunning success of Japanese manufacturing in the 1980s had come from the low cost of capital. As Japanese firms began to confront borrowing costs and price-earnings multiples much more like those in the West, they lost the big competitive edge that low capital costs had provided them. For this reason, and because of growing Western political resistance to Japanese trade practices, analysts have lowered projected sales and earnings of Japanese firms.

Thus the drop in Japanese stock prices was associated both with lower projected future earnings and with a higher discount rate applied to those future earnings. Neither change has a parallel in the U.S. economy. If anything, U.S. interest rates and growth prospects have moved in opposite directions to Japan's. So there is no basis for similar stock price movements based on similar changes in fundamentals.

Pure price contagion, the second possible source of correlation, seems dubious in general and is especially unlikely when one market's investors are a relatively small factor in the other market. And despite frequent assertions to the contrary, we have not become dependent on Japanese investment dollars. In the peak year, 1987, Japanese investors made net purchases of \$11 billion of U.S. stocks. Since then, their net purchases have averaged about \$1 billion a year. This activity is dwarfed by inflows to U.S. stock mutual funds, which came to \$20 billion in the first quarter of this year alone. So the U.S. market is no more likely to be pulled down by Japan's via contagion than it is through common fundamentals. If we get a major decline in stock prices, it will be homegrown, not made in Japan. ■

George L. Perry is a senior fellow in the Brookings Economic Studies program. With William C. Brainard, he directs the Brookings Panel on Economic Activity and edits its journal, the Brookings Papers on Economic Activity.

Democracy and Reform in the Americas

BY CARLOS PAREDES

During the 1980s Latin America's standard of living deteriorated badly. Early in the decade the region faced severe external economic shocks, including declining terms of trade, high interest rates, and a sharp curtailment in bank lending, all of which led to the unfolding of the international debt crisis. The negative effects of these shocks were compounded by domestic policy mismanagement, producing a pervasive and unprecedented economic downturn.

In the reform programs that followed, budget deficits were slashed, subsidies and price controls were eliminated, currencies depreciated, domestic markets were opened to foreign competition, and market mechanisms steadily replaced government intervention. Although in most cases these reforms helped restore economic stability and make sustainable growth possible, the social costs were heavy and unfairly borne by the poor. Not only did severe income inequality not improve, but also overall economic activity declined: income per capita in the region fell 10 percent. The number of people under the extreme poverty line increased dramatically. Not surprisingly, the 1980s are commonly referred to as Latin America's lost decade.

Despite the grim economic situation of the 1980s, Latin America made notable progress toward democratic rule. One by one, military dictatorships were replaced by democratically elected civilian regimes. With the sole exception of Chile, the military retreated to their barracks, leaving the painful task of economic reform to civilian governments in young and fragile democracies.

The advent of democratic rule brought with it expectations of vastly increased material welfare that clearly

could not be fulfilled in the short run. As the dismal economic record of civilian governments of Argentina, Brazil, and Peru during the 1980s makes clear, the challenge of economic reform was more than they could handle.

By the end of the 1980s, after years of declining standards of living, Latin voters turned to charismatic politicians who promised a new wave of populism. Carlos Andres Perez in Venezuela, Carlos Menem in Argentina, and Alberto Fujimori in Peru were all elected based on campaign platforms that they completely neglected as soon as they were inaugurated. Instead of unsustainable populist policies, they delivered harsh adjustment programs. Their dramatic departure from their campaign promises not only surprised their supporters but weakened these countries' emerging democratic institutions. All three countries have now suffered coup attempts, the Peruvian one led by Fujimori himself.

The successful economic reforms in Chile and Mexico, carried out by political regimes that were at the time a far departure from multiparty democracies, and the success stories of Southeast Asia have led some analysts to wonder whether democracy and economic reform are simply incompatible. Were the successful economic reforms attributable to the stability and greater powers of the non-democratic governments that carried them out? Wasn't the February coup attempt in Venezuela a reaction to the harshness imposed by Perez's reforms? And, finally, wasn't Fujimori forced to dissolve the Peruvian Congress and to reform the Judiciary so that his government would be able to deepen and solidify its market-oriented reforms?

The answer to all three ques-

tions is the same: no. The stability of economic policy in Colombia since the mid-1960s and the dramatic and far-reaching economic reform in Bolivia since 1985 show that democracy and market-oriented reform *are* compatible. In fact, the recent coup attempt in Venezuela is best explained not by economic factors (output growth in 1991 surpassed 9 percent and inflation continued to fall), but by the weakness of the country's democratic institutions. The fact that most of the population considered a coup possible—and perhaps desirable—opened the way for February's senseless military adventure. Blatant corruption scandals are another explanation. Corruption has essentially gone unpunished in Venezuela, and that served, as in the case of Peru, as an excuse for the coup.

Finally, Fujimori's need to further economic reform does not provide a rationale for his auto-coup in April. In fact, his economic program has been seriously endangered by this move, which immediately shut off foreign aid, jeopardized the country's reintegration into the international community, and deprived Fujimori of his hard-earned international credibility and respectability. After enduring 20 months of hardships imposed by the reform program, Peruvians must now deal with the sad reality of probable financial isolation once again and, moreover, of being the latest political pariah in the hemisphere. Fujimori's action was a huge political and economic blunder.

The recent international support for Perez and censure for Fujimori indicate a growing recognition of the philosophical complementarity of economic and political liberties. Leaders in the region, both military and civilian, must hear and understand the signals provided by these alarming events. ■



Carlos Paredes is a research associate in the Brookings Economic Studies program. He is the editor, with Jeffrey D. Sachs, of Peru's Path to Recovery (Brookings, 1991).

Ross Perot Is No John Anderson

BY GERALD M. RAFSHOON



May 17, 1992. Please note this dateline. By the time you read this, everything may have changed completely. In politics, a week is a lifetime.

But as of today, a TIME/CNN poll has Mr. Ross Perot running first nationwide with 33 percent of the vote, President George Bush at 28 percent, and Governor Bill Clinton with 24 percent. In 1992, it's probably better to be a Mr. (or Ms.) than a President, Governor, or any other form of incumbent.

Conventional wisdom in Washington is that Perot looks good in the spring, but he will fade in the fall like all third-party candidates. Inside the Beltway, he's compared with John Anderson.

The line is that when he undergoes personal scrutiny and a close examination of his ideas, he'll be finished. Really? So far, throughout the first part of May there have been daily stories about how he has no real answers concerning the major issues: that he isn't really an outsider, having had a relationship with the Nixon crowd (key reliable sources include Bob Haldeman, John Erlichman, and Charles Colson); that he might be a fascist; and that if he were elected he couldn't govern without a party base. During this period his stock has gone from being tied for second to being in first place. No other independent in history has ever been there before.

Perot is not another John Anderson. Anderson never led Ronald Reagan or Jimmy Carter in the polls. Furthermore, his candidacy was not the result of a grass roots rebellion. Anderson was a failed Republican presidential candidate who had not won a single primary. He could hardly be called a nonpolitician, having been part of the Republican leadership in the House of

Representatives, where he served for 20 years. After his media consultant spent all his federal funds, Anderson wound up with 6 percent of the popular vote and did not carry one state.

Perot's candidacy is quite different. The electorate is far more disenchanted with their party choices than they were in 1980. Both Bush and Clinton have what pollsters call net negative ratings. After being lied to by Reagan and Bush and after having witnessed a dreary Democratic primary contest and the sorry spectacles on Capitol Hill, people are more alienated than ever before and detest politicians of both parties. Furthermore, they like Perot.

People like Perot because he's an outsider in a year when the electorate has had it with insiders. They also like him because he says what he thinks, he's a man of action, he doesn't rely on others to tell him what to do, and he knows and seems to care about the real problems we face.

The Texas businessman is now working on coming up with acceptable answers to all the nagging questions that the media has been asking him. On abortion, gun control, entitlements, West Bank settlements, global warming treaties, and especially the budget deficit. I suspect that when he comes down from the mountain with these "stands on the issues," he will give us straightforward examples of how he differs from Bush and Clinton. Probably answers revolutionary enough to offer real change and yet not so outrageous that he scares people. That's about all he has to do "on the issues." He says people want him to talk about principles rather than positions. Maybe that's so.

Then what happens? Well, we have a campaign. Maybe

even a debate or two or three. Some advertising. For the first time in recent history the Republican candidate may not be the one who is able to spend the most money.

If Perot doesn't fall because of some major gaffe or real skeleton in his closet, his goal will be to hold on to the independent base he already has (around 30 percent) and then chip a few points away from the president and Clinton. He has greater potential than Clinton in California and in the traditionally Republican Western states. Bush is mighty unpopular for a Republican in that region. In the Democratic states such as New York, Perot's stands on social issues could give a lot of Democrats who voted for Jerry Brown and Paul Tsongas and nobody in the primaries an excuse to come over to him. If he gets up to 40 percent or better, you're talking about a real horse race.

In the final analysis, it's possible that Ross Perot's candidacy is not one that will simply influence the outcome by tipping the scale one way or another. He could bomb out because of some gigantic personal or political flaw. Or he could very well become the 42nd president of the United States.

And they said '92 was going to be a dull political year. ■

Gerald M. Rafshoon, currently an independent film and television producer, directed the 1975-76 advertising campaign for a long-shot presidential candidate, Jimmy Carter.

Continued from page 4

countervailing duty laws do not become protectionist devices. The administration's approach is not to reform U.S. trade laws unilaterally, as the authors suggest, but to use reforms sought by other nations to bargain for reforms of interest to the United States. The process may take longer, but a better outcome will be achieved for the United States and the trading system as a whole.

First, strengthening the Antidumping and Subsidies Codes to provide for greater transparency, due process, and judicial review in unfair trade investigations, as proposed by the administration, will go a long way toward stopping the improper use of such laws by U.S. trading partners. Daylight in the investigatory process will yield fairness and objectivity. Second, reform of rules governing such issues as "sales at a loss," "constructed value" and "averaging" may make sense in certain cases, but only in exchange for "reform" of another recognized flaw in the antidumping and countervailing duty laws, the ease with which they are circumvented. So far, finding the balance between the need for tougher anticircumvention rules and the need for reform in certain computational areas has eluded the negotiators. But when the Uruguay Round gets back on track, reform of the antidumping and countervailing duty laws is inevitable.

On a number of other points, Boltuck and Litan are simply wrong. Contrary to their assertion, the Subsidies Code does not require that a countervailing duty be lower, if a lesser duty is sufficient to remove the injury caused by the subsidy. The Code expressly provides signatories with discretion in this area. Thus, U.S. practice is in full conformity with its Code obligations. Boltuck and Litan are also wrong in suggesting

that the United States does not employ an "effects test" in countervailing duty cases. Duties are imposed in virtually all cases only if the subsidized imports are, through the effects of the subsidy, found by the International Trade Commission to be causing injury to the relevant domestic industry. The United States does not, and should not, try and discern which part of the subsidy has an effect on price behavior. Subsidies are fungible. Money provided by a government to a firm to subsidize production for domestic markets frees up resources for the firm to lower prices in export markets.

Eric I. Garfinkel, Council on Competitiveness

A Retrencher, Not an Isolationist

■ Steve Hess ("A Race for Secretary of State," spring issue) describes me as a "new" isolationist. I prefer to call myself a realist, but Henry Kissinger already has this label in Hess's scheme of things (although how anyone who helped ruin the American economy and tear apart American society for more than four years for the sake of South Vietnam qualifies as a realist is beyond me.) I could live with "retrencher." Could Hess?

I'm intrigued by Hess's idea of sponsoring something of a Secretary of State contest. But I'm not sure I agree that the candidates have ignored the foreign policy debate. In my view, the focus on domestic issues, at least by the Democrats, implicitly endorses the kind of shift in national priorities away from foreign policy that I and others have explicitly called for. That the American people have not demanded that they speak out on foreign policy indicates that the voters agree.

Alan Tonelson, Economic Strategy Institute

Don't Just Dump Cases on State Courts

■ Several years ago, when I was secretary of the Eleventh Circuit District Judges' Association, we took a vote on a proposal to abolish diversity jurisdiction (Frank M. Coffin, "Judicial Gridlock," winter issue). The vote was 33 to 0 against. Most federal judges who oppose abolishing diversity jurisdiction do so for three reasons. First, they recognize that there is still a strong likelihood of "parochial" justice, particularly in small counties. The combination of an independent judiciary and, in most instances, a wider juror base helps to overcome possible bias. Second, they recognize that the absence of diversity jurisdiction would make for very dull judging. And, third, they recognize that the legal system should be considered as a whole, and that merely dumping cases on state courts provides for no long-range solution.

I would suggest that, rather than abolishing diversity jurisdiction, we all look for ways to "abolish" the practices that permit the frivolous, nonmeritorious, overcostly, overly adversary, time-consuming litigation that pervades our courts. Merely because litigation is premised on federal law does not somehow place it on a loftier plane. Another solution would be to write clear legislation without reliance on legislative history, implied private rights, retroactivity "principles," and the myriad other legislation construction issues that cost millions upon millions. A better specific solution would be to limit more significantly supplemental jurisdiction with respect to state law claims. Such jurisdiction often serves to confuse the issue.

Robert B. Propst, U.S. District Court, Northern District of Alabama

The Demons of History

■ Whatever one may think about Francis Fukuyama's "End of History" theory, it is only from a global perspective that dramatic developments in the postcommunist world may be assessed. Shlomo Avineri ("The Return to History," spring issue) challenges Fukuyama: "Far from seeing an end of history, Eastern Europe now goes through a massive return of history and to history." And he is completely right. That is why, throughout the postcommunist world, there are more "revivals" than new constructions; and that's why there are legitimate fears that the nationalist spirit characteristic of the period between the two world wars is back.

Is there any counterbalance to it? I think the direct involvement of the "posthistorical" West (efforts to mediate conflicts, peacekeeping forces) has proven ineffective. The postcommunist nations should—and I think shall—"make it" themselves. They not only want to revoke their own past selves, but also to "join the world" (from which communism isolated them) as equal and dignified members. The world, however, has much changed since a part of it fell victim to communism. To join it, a different model of the relationship between nationality and statehood should be acquired. For postcommunist nations, this demands quite an effort. But making that effort is the only way to pacify the awakened demons of history.

Ghia Nodia, Kennan Institute for Advanced Russian Studies

The Review welcomes comments from its readers. Letters will be edited to conform to style and space.

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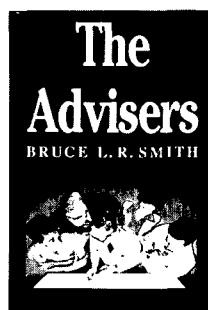
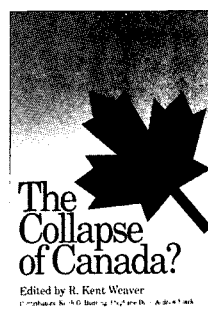
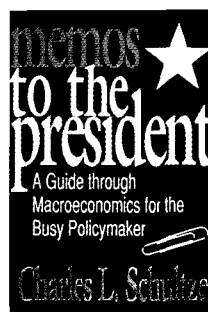
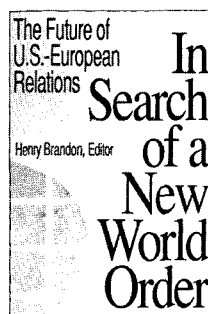
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